

BANK STATE AID IN THE FINANCIAL CRISIS

FRAGMENTATION OR LEVEL PLAYING FIELD?

A CEPS TASK FORCE REPORT

CHAIR: ALASTAIR SUTTON

**RAPPORTEURS: KAREL LANNOO
CHRIS NAPOLI**

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**CENTRE FOR EUROPEAN POLICY STUDIES
BRUSSELS**

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Centre for European Policy Studies
Place du Congrès 1, B-1000 Brussels
Tel: (32.2) 229.39.11 Fax: (32.2) 219.41.51
E-mail: info@ceps.eu
Website: <http://www.ceps.eu>

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EXECUTIVE SUMMARY

The financial crisis has posed an enormous challenge for the EU's state aid regime. Conceived to ensure a level playing field in the single market, the scheme also had to show that it could be adapted to exceptional circumstances. The size and nature of the aid, the number of the schemes and the complexity of the cases that had to be examined and approved were overwhelming. Although some high-profile cases of bank state aid had been dealt with by the European Commission in the past, never in the EU's half-century of history had the European Commission dealt with so many cases in such a short period of time. The approach followed during this period will thus continue to influence policy-making for a long time to come.

During the crisis, 20 bank debt guarantee and 15 bank recapitalisation schemes and 44 cases of individual bank aid cases were dealt with by the European Commission under the state aid rules. At the height of the crisis, the effectively committed aid amounted to some 13% of the GDP of the EU. The final amount may be lower, however, as the biggest part of aid was granted in guarantees of bank liabilities, which disappear as soon as soon as the guarantee is withdrawn, and the aid is remunerated, provided the financial system stabilises.

During 2008-09, the European Commission gave guidance to the private sector about its policy in applying state aid rules to the financial sector. The EU published four Communications, but it remains an open question whether this was the appropriate way to proceed, and how closely this policy was applied in practice. Considering the approach taken in specific state aid cases, it seems that the policy followed was more ad hoc. Some general principles were followed, including new conditions that had not been applied before, but it seems that the end result, certainly at European level, is a more uneven playing field. Some member states' banks were in better shape when the crisis hit, but some states were also better prepared to respond to the crisis and to make their state aid schemes compatible with EU rules. Different forms of restructuring packages were thus not necessarily only bank-specific, but also country-specific.

The legal provisions of the EU framework to assess state aid are unique. The EU is the only international entity with real powers to assess

aid and its distortions to competition and trade, and to enforce remedies, but its framework is limited to aid given by EU member states. Beyond that, the EU needs to rely on international agreements, most importantly the WTO's General Agreement on Trade in Services (GATS), which are much weaker than the existing provisions in the EU, and without having developed any case law so far.

This report is a distillation of the discussions held within the CEPS Task Force on Bank State Aid in the Financial Crisis. The report puts forward the following nine recommendations.

Recommendations

1. A comprehensive view is needed on the role played by state aid during the financial crisis. The financial system was rescued thanks to the concerted efforts of governments, central banks and international authorities. But coordination needs to be enhanced inside the European Commission and with the member states, as the crisis has provoked a number of responses, of which state aid is only one. A bigger role could have been played by the EU Council and the European Parliament in coordinating the response, and in ensuring a more homogeneous policy, in establishing a special procedure for this unprecedented situation.
2. A higher level of awareness is needed within the member states of the application of the EU's state aid policies. An *ex-post* analysis seems to indicate that some member states were more aware of the state aid rules than others in the design of the bank rescue packages, resulting in a more uneven playing field after than before the crisis.
3. As the recovery was the result of a joint effort between states, central banks and the EU authorities, the exit strategy should also be carefully planned among these actors. As far as possible, the exit strategies should also be coordinated with the overall economic recovery strategies of member states. This is particularly true for state aid policy.
4. Cross-border coordination of the reduction of state aid support measures should be mainly pursued for those elements that are most distorting, i.e. different forms and degrees of support for bank debt. However, considering that the quality of the guarantor and size of the problem differs considerably across EU member states, and continues

to differ as the economic circumstances differ, a more pronounced coordination may be very difficult to achieve.

5. Greater openness is needed in state aid processes. A broader involvement of stakeholders in the consultation on the general policy of state aid and in specific cases would be useful. At the moment, there is no genuine and systematic consultation at EU level.
6. The EU should continue to analyse the impact of the aid and its various measures on the level playing field. An overall *ex-post* assessment of the crisis, of the state aid given to the financial sector, and of the EU's policy response is therefore needed. Following Treaty Art. 108.1, the Commission has a duty to monitor the implementation of its decisions.
7. There is an uneven playing field at the international level, with the European Commission scrutinising aid by the member states to European banks, while nothing comparable exists elsewhere. A framework is in place at the WTO level, but it is very rudimentary compared to the EU scheme, and leaves huge scope for carve-outs. EU banks may thus also be disadvantaged internationally by the tight EU regime.
8. At the global level, the London and Pittsburgh G-20 summits stated the importance of "cooperative and coordinated exit strategies". However, given the above, this seems very difficult to implement in practice. A mechanism is needed to facilitate multilateral coordination of exit strategies, which permits adjustment in the interest of fair competition. One international organisation should be mandated to act.
9. In the future, a European crisis management and resolution framework should be considered in order to deal with banks in trouble, but any proposed resolution or authority must integrate and clearly specify the EU's state aid rules and objectives of proportionality, necessity and focus. The involvement of the European Systemic Risk Board (ESRB) and European Banking Authority (EBA) in such a new framework would be essential.

INTRODUCTION

Control of state aid is a core EU task, enshrined in the EU Treaty from the start. Its objective is to ensure that government interventions do not distort competition and trade inside the EU. State aid is defined as an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities. Subsidies granted to individuals or general measures open to all enterprises are not covered by Art. 107 of the EU Treaty (TFEU) and do not constitute state aid.

The EC Treaty pronounces a general prohibition of state aid. In some circumstances, however, government interventions can be permitted. These concern regional development, response to serious economic disturbances, and aid to economic sectors in trouble. The European Commission has the sole competence to decide when state aid can be permitted. The Treaty provides that all new aid measures must be notified and approved by the European Commission prior to their implementation; if not, the aid is invalid. It is only after the approval by the Commission that an aid measure can be implemented. Incompatible state aid can be recovered. The Commission can be overruled by the EU Council of Ministers, which can decide, acting unanimously, that aid is compatible with the single market, in derogation from the provisions of Art. 107.

Until the crisis hit, the experience of applying state aid rules to the financial sector was limited to a few, but high profile cases. The best known cases involved Crédit Lyonnais and the German regional banks ruling. In the former case, the European Commission decided in 1995 that Crédit Lyonnais, in return for receiving the green light on the €6.9 billion (FF45 billion) in state aid, had to reduce its commercial operations abroad, including a substantial part of its European banking network, by at least

35% by the end of 1998.¹ In the German Landesbank case, the European Commission agreed with the German government in 2001 and 2002 to abolish the system of state guarantees for Landesbanken and savings banks and to distinguish between the public policy and purely commercial tasks of these institutions. The continuing use of state guarantees was allowed for public policy tasks such as financing of SMEs, infrastructure, investments for environmental protection, housing and cooperation with developing countries.²

Some have argued that the EU's state aid rules are not entirely appropriate for the banking sector, because of its special nature (Grande, 1999). Public subsidies may be needed in the banking sector to achieve the objectives pursued by regulation and supervision, and may not necessarily distort competition. When combating systemic risk, state aid is used to prevent a serious disruption of the financial system, and of the overall economy. In addition, the aid may be granted through special liquidity support by the central bank. Hence the overall public interest is at stake, not simply a private one. This public interest is essentially monitored by national supervisory authorities and central banks, implying that the control of state aid, when related to supervisory and systemic stability issues, should be in their hands.

The outbreak of the financial crisis forced policy-makers to come to terms with a calamity – the proportion of which they could not have imagined before, and to which they had to respond rapidly. For comparison, the overall level of state aid granted in the EU between 2002 and 2007, expressed as a percentage of GDP, decreased on average by around 2% per year and stood at less than 0.5% in 2007 (European Commission, 2009d).

This report analyses, from different perspectives, the huge amounts of aid that were given to the financial sector. Section I offers an overview of bank state aid policy during the crisis. It demonstrates that there are vast differences in the way member states have offered and implemented aid to the financial sector and that these differing policies have called the coherence of the single market into question.

¹ European Commission, 95/547/EC of 26.07.1995.

² European Commission, Decisions of 17 July 2001 and 1 March 2002.

Section II discusses the approach followed by the European Commission on the basis of the competences foreseen in the EU Treaty and poses some alternative options. It addresses the question of whether the European Commission is pursuing an industrial policy through its state aid decisions.

Section III of this report examines state aid in the global context. It questions whether existing international tools for ensuring a level playing field for banks are sufficient, given the global nature of the industry. Conclusions from this section demonstrate that global standards on aid to the financial sector are underdeveloped.

I. AN OVERVIEW OF STATE AID PROVIDED DURING THE CRISIS

The EU's state aid policy for the financial sector was not challenged during the first year of the financial crisis (August 2007-August 2008). It was only in the aftermath of the collapse of Lehman Brothers in September 2008 and after the special Eurogroup meeting in Paris on 12 October 2008 that its application was temporarily relaxed to deal with the extraordinary circumstances in financial markets. In the absence of a European bail-out plan, the October 12th Eurogroup meeting decided that:

- Governments can provide state guarantees to bank debt issues for up to five years under well-determined conditions, and can participate in these issues. All banks should be eligible for these operations, including foreign-owned banks; and
- Governments can take equity stakes in financial institutions and recapitalise banks in trouble.

The Eurogroup requested that governments avoid national measures that would negatively affect the functioning of the internal market and harm other member states. The Eurogroup committed to “coordinate in providing these guarantees, as significant differences in national implementation could have a counter-productive effect, creating distortions in banking markets”. The support actions would be “designed in order to avoid any distortion in the level playing field and possible abuse at the expense of the non-beneficiaries of these arrangements”.³

The Eurogroup suggested that the European Central Bank (ECB) should fulfil its role in assuring sufficient liquidity for the financial sector

³ Eurogroup meeting, 12 October 2008, pp. 2-3.

and reacts with flexibility to market circumstances. In particular, the ECB was asked to ease its rules on assets that qualify as collateral in liquidity-providing operations, on which the central bank acted a few days later. From that moment on, the ECB dramatically expanded the eligibility criteria of marketable and non-marketable assets, including the lowering of the credit threshold for these assets from an A- to a BBB- credit assessment by an eligible External Credit Assessment Institution (ECAI) or rating agent.⁴

The Eurogroup's decisions were later endorsed by the autumn European Council (October 2008), which broadened their application to the EU as a whole. The European Council endorsed a flexible interpretation of the EU's state aid rules, given the exceptional circumstances.⁵ EU leaders allowed bank state aid so as to restore financial stability and resume credit flows.

Hence, to have a correct picture of 'state' support during the crisis, the different actions must be seen in combination. Enhanced credit support by the European Central Bank and quantitative easing by the Bank of England could also be considered as a subsidy to the financial system, but are not considered as such under the EU's state aid rules. The full list of elements comprises:

- **Government: financial sector stabilisation measures**
 - Equity capital support
 - Debt support
 - participation in debt issues
 - underwriting of subordinated debt
 - guarantee of bank deposits
 - overall guarantee of bank liabilities
 - guarantees for interbank lending and bank bonds
 - Short-term liquidity support
 - Support for impaired assets in asset support programmes and 'bad bank' schemes

⁴ ECB, "Measures to further expand the collateral framework", Press release, 15 October 2008.

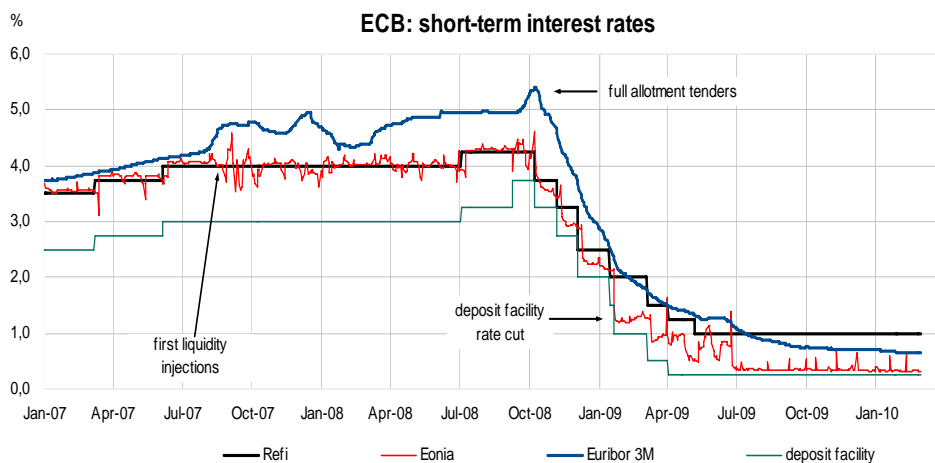
⁵ European Council, 15-16 October 2008, p. 2.

- **Central bank: monetary policy and liquidity support**

- Enhanced credit support, composed of full allotment, expansion of eligible collateral, longer-term credit provision and direct purchases of securities (quantitative easing)

Figure 1 clearly shows that the policy was successful for the eurozone. The enormous spread between the 3-month euribor and the ECB's main refinancing rate was gradually narrowed as a result of the exceptional measures agreed upon at the Eurogroup meeting. It is thus the combination of state aid, the ECB's monetary policy and enhanced credit support that stabilised the situation.

Figure 1. Evolution of the ECB's refinancing rate and 3-month Euribor (Jan 2007- early 2010)

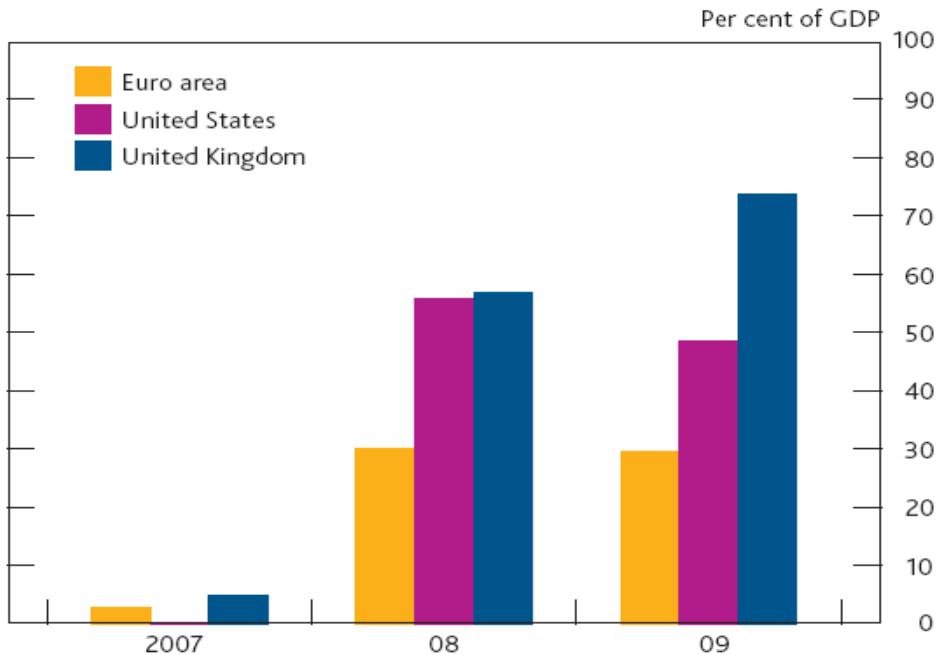


The 3-month Euribor stabilised at 0.7% in the last quarter of 2009, or well below the ECB main refinancing rate of 1%, which indicates that liquidity is abundant. This already underscores the difficulty of defining and implementing exit policies. Indeed, the ECB needs to ensure some coordination with other European and national authorities when it starts reducing liquidity in its credit support operations, as difficult as this may be to reconcile with its independence.⁶

⁶ The ECB intended to start reducing the eligible collateral in credit providing operations, but the Greek budget crisis in early 2010 forced it to delay this measure.

The intervention of the ECB contrasted, at least in the initial phase, with those of other central banks, in particular with the Fed and the Bank of England, which were more active in the direct purchase of securities with the so-called ‘quantitative easing’ schemes. In addition, asset support and debt guarantee programmes were more extensive in the US and the UK than in the eurozone, in the sense that a distinction could be made between the ‘Anglo-Saxon’ world and continental Europe in the response to the crisis. According to numbers released by the Bank of England, state support for the financial sector, including central bank assistance, was up to 74% of GDP in the UK, 48% in the US, compared to 28% in the eurozone. This has changed with the sovereign debt crisis of the first half of 2010, although it is too early to have a clear view on the costs.

Figure 2. State support for the financial sector



Greek government paper is rated BBB- (Fitch, S&P), which would have curtailed access of Greek banks to the ECB's liquidity providing operations. See: ECB press release, 3 May 2010 (<http://www.ecb.int/press/pr/date/2010/html/pr100503.en.html>).

Source: Bank of England (2009).

Types of state aid

State aid to the financial sector can be offered in four main forms. First, governments can *guarantee* bank deposits, bank bonds or all bank liabilities. As deposit guarantee schemes are designed for retail depositors and limited to a fixed maximum amount, they do not raise a state aid issue. To the extent that the deposit protection fund is used to bail out a bank, as happened in the Banesto (1993) and Banco di Sicilia (1995) cases, the EU's state aid rules apply. Deposit protection can be extended to cover a broader set of bank liabilities so as to prevent gridlock in the financial system, as was done in Ireland in the Eligible Liabilities Guarantee scheme.⁷ Governments can also specifically guarantee certain bank loans and bonds to maintain the ability of banks to raise funds. Such guarantees should be remunerated.

States can provide *equity* support to strengthen the capital base of financial institutions. In recapitalisation programmes, governments inject funds into banks in exchange for direct equity, preferred shares or subordinated debt (as a form of hybrid capital). In a situation of serious distress, as the financial crisis, banks may need new capital, which will be difficult or impossible due to market uncertainty. Recapitalising banks can improve the functioning and stability of the banking system and maintain financing flows to the wider economy.

A special form to absorb losses in the financial system is the creation of a so-called *bad bank*. In a bad bank, banks get a delay to reimburse their creditors until the financial system normalises, and assets recover. It could thus be considered as a form of Chapter 11, with the understanding that bad banks are separate legal entities. Bad banks can be private, held by the bank in trouble (see the German bad bank scheme in Annex 4) or by the banking sector at large, or they can be owned by the state. Relieving financial institutions of impaired assets can help a bank strengthen its balance sheet, re-gain access to liquidity, and reduce leverage. Bad bank schemes raise fundamental competition policy problems, however, related to determining the new book value of the impaired assets, tackling the distortions created by the schemes and justifying the scheme to taxpayers

⁷ See European Commission, State aid case N 254/2010 of 16.06.2010.

when public money is used to pay for bad assets to banks in trouble, as was the case in Ireland.

The final form of state aid is the *nationalisation* of banks. Under a nationalisation programme, a large part of or all assets are taken over by the state. Nationalisation itself is not a form of state aid – the EU Treaty is neutral with regard to the form of ownership – it is the capital injection in a bank in trouble that forms state aid. In most cases, the goal of nationalisation is to return the bank to health with the objective of one day returning it to the private sector.

Indirect state support to the financial system

Central banks can indirectly ‘aid’ banks through the conditions of the liquidity-providing operations. In normal circumstances, central banks control money supply through the central interest rate on credit for the banking sector. Banks can access liquidity in exchange for collateral. In normal circumstances, eligible collateral is limited to high-quality securities, on which a haircut is applied. The ECB for example applies a fixed valuation haircut of up to 5% on 10-year government bonds (declining with maturity), or up to 14% for asset backed securities. To cope with market fluctuations, margin calls are applied by the ECB. During the financial crisis, the ECB lowered its conditions for acceptable collateral from A- to BBB-, without changing the valuation haircuts. This implies that securities may well have been accepted by the central bank with valuation haircuts that were above the market price at a given moment, allowing banks to arbitrage. It is unclear whether the margin calls have been fully applied in the volatile financial market context of the last two years, or whether they have been utilised for less marketable financial instruments.⁸

In its most extreme form, central banks can buy assets directly in the markets at distressed prices to inject liquidity and trust into the financial system (‘quantitative easing’), as was widely carried out in the UK and the US. These operations artificially shore up the value of the assets, and are a

⁸ The liquidity categories of the valuation haircuts were changed in September 2008 and the valuation haircuts increased in July 2010. See latest changes to risk control measures in Eurosystem credit operations, European Central Bank, Press notices, 4 September 2008 and 28 July 2010. For the changes as a result of the crisis, see ECB press release, 15 October 2008.

clear form of indirect state support to the financial system. Quantitative easing, however, is risky and may affect the capital base of the central banks.

Within EMU, direct aid by central banks to the financial system is forbidden by the Treaty. In the case of Fortis, however, the Belgian central bank (NBB) gave emergency liquidity assistance of €60 billion, which had to be specifically authorised by the ESCB.⁹

EU state aid policy during the crisis

The remainder of this report will focus solely on direct state aid during the crisis, which posed a fundamental challenge for the application of the EU's competition policy rules. The announcement of the Irish Credit Institutions Financial Support scheme on 27 September 2008 was the first of a cascade of national bail-out plans, all of which raised to a greater or lesser degree single market competition policy problems. From the early days of the financial crisis in the autumn of 2007, the EU continued to apply its state aid policy, for example in the Northern Rock, IKB or Sachsen LB cases. With the start of the systemic crisis in autumn 2008, it temporarily accepted the exceptional circumstances of the crisis and let financial stability concerns precede over the strict application of the state aid rules.

By mid-2010, the European Commission had been notified of 20 state debt guarantee and 15 recapitalisation schemes, and 44 specific bank state aid cases.¹⁰ Thirteen of the old member states (except Belgium and Luxembourg) had a national scheme, and seven new member states (Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia and Cyprus). Five

⁹ Such support can happen in the eurozone on the basis of specific collateral requirements, although it is unclear what these were in the case of Fortis. In its opinion on the Belgian law on the subject, the ECB stated that the 'State must guarantee to the NBB the repayment of any credit granted in the context of the NBB's contribution to the stability of the financial system and must guarantee the NBB against any loss' as it concerns a form of prohibited monetary financing (TFEU Art. 123.1), which affects the independence of the central bank. ECB, Opinion of 8 October 2008 on the draft law, (CON/2008/46).

¹⁰ This number counts cases concerning one and the same bank only once. See latest Commission note dated 29 June 2010 and recent press releases from DG Competition on: <http://ec.europa.eu/competition>

EU member states had neither bank support schemes nor individual bank support cases, all of these new member states (Bulgaria, Czech Republic, Estonia, Malta and Romania). The national support schemes are in some cases limited to guarantees only, but can also comprise recapitalisation or bad bank schemes (see Annexes 1, 2 and 5). Germany and the UK had the most comprehensive national schemes, whereas Germany also had the highest number of individual bank cases (13). At the time of writing, nine specific cases were still under formal in-depth investigation, including some high-profile cases such as Hypo Real Estate. Since delays occur in the publication of detailed conclusions on cases, or not all details are made public, information may not have been available at the time of drafting this report.

The total amount of aid granted to the financial sector during the crisis added up to €4.1 trillion, one-third of the EU's GDP. It consists of general and ad hoc support for financial institutions, composed of short-term liquidity support, state guarantees of the interbank market, equity (recapitalisation) and debt (subordinated debt) financing, and support for bad bank schemes. €1.5 trillion (12.5% of GDP) of this amount has been effectively used, a figure that may not grow further, provided the situation further stabilises. State guarantees on bank liabilities represent the largest budgetary commitment among the aid instruments, with €3.1 trillion (25% of EU GDP) of approved measures, out of which €1 trillion (8% of GDP) have been effectively granted (see Table 1).¹¹ These guarantees were provided in national schemes, with varying legal frameworks and timelines (see Annex 2 and 5). As shown in the annex, guarantee schemes differed in three respects: the amounts granted, the eligibility of institutions, and the conditionality placed on recipients.

- In terms of amounts, allowances available ranged from €15 billion (Greece) to unlimited (Ireland, Belgium and Denmark).
- Eligibility: certain countries were much more restrictive with respect to which firms were eligible for guarantees. For example, Ireland made allowances available to any financial institution with a systemic relevance to the Irish economy. By contrast, the Dutch scheme was

¹¹ The ECB (2010) also published its assumptions on the cost of the financial crisis, which are, for the euro area, on the basis of the contingent liabilities, at least 20% of GDP.

open only to those institutions defined as banks and having their corporate domicile or substantial operations in the Netherlands, and with an acceptable solvency ratio.

- Concerning conditionality, while many schemes placed restrictions on executive pay, only some placed restrictions on balance sheet growth, and fewer made guarantees available only to “fundamentally sound institutions”.

Table 1. Public interventions in the EU banking sector

| in € bn | General measures (A) | Ad-hoc support (B) | Total (C=A+B) | Effectively used (D) | Share (D/C) | % GDP (D/GDP) |
|-------------------------------|----------------------|--------------------|---------------|----------------------|-------------|---------------|
| Debt guarantee schemes | 2,747 | 402.8 | 3149.8 | 993.6 | 31.5 | 7.9 |
| Re-capitalisation | 338.2 | 164.9 | 503.1 | 241.6 | 48.0 | 1.9 |
| Support for bad asset schemes | 376 | 54 | 430 | 322 | 74.9 | 2.6 |
| Liquidity support | 41.9 | | 41.9 | 41.9 | 100.0 | 0.3 |
| Total | 3,503.1 | 621.7 | 4,124.8 | 1,557.2 | 37.8 | 12.5 |

Note: For country specific data, see European Commission (2009a).

Source: European Commission (2010). Data up to 31 March 2010.

During the crisis, the European Commission’s Competition Directorate published several Communications to try to bring some order in the national support schemes. However, the Commission only succeeded gradually in doing this, as the crisis receded and the need to preserve the single market re-emerged as a policy priority. Issues such as non-discriminatory access or unjustified protection of shareholders were apparent but initially led to no or limited reaction on the part of the EU. In total, the European Commission published four Communications (see the summary in Annex 3). The first Communication sets out the general principles to be respected, the successive ones focus on aspects of it, i.e. the required remuneration for state support, the treatment of impaired assets and the restructuring plans in the return to viability. Overall, the Commission’s objectives are:

- to demonstrate a capacity for an effective Community-level response to the financial crisis,

- to limit negative spill-over among member states,
- to protect the single market and
- to minimise competitive distortions and moral hazard.

It should be recalled that many of these single market distortions and thorny competition policy problems could have been avoided if a European-wide bank resolution and crisis management framework had been in place.

The most important document in the context of this report, and the future shape of the European banking markets, is the July 2009 Communication on the return to viability. It states that the Commission will examine restructuring plans in view of:

- *a thorough diagnosis of a bank's problems.* The starting point for a viability plan with, where applicable, disclosure of impaired assets and off-balance sheet items.
- *a restructuring plan with a flexible and realistic timing.* A viability plan requires a stress test. It should demonstrate how the bank will return to viability without aid as soon as possible (maximum term is five years), giving details per business line on the re-structuring, funding, risk controls, governance. It should also analyse alternative considered options, such as sale of the bank or break-up.
- *clear burden-sharing between the member state and beneficiaries.* The aid should be limited to the minimum necessary, which can include the sale of assets, although the Commission acknowledges that absolute thresholds cannot be set *ex ante*. Aid should be remunerated, but cannot be used to pay dividends or subordinate debt holders.
- *measures to limit distortions of competition.* These will again be case-specific or tailor-made, as many elements have to be taken into consideration: the survival of the bank, the maintenance of the single market, the promotion of competitive markets. State aid cannot be used for acquisitions, a condition that applies for at least three years.

In applying these rules, the European Commission has accepted new conditions. It has accepted the recapitalisation of banks during the crisis, not only emergency loans and special guarantees. For non-financial corporations, the rule is that recapitalisation is only accepted after the restructuring. Recapitalisation is also seen as a more permanent measure than loans and guarantees, meaning that aid becomes longer-term, and

thus more permanent, than the state aid rules as applied before. Finally, the Commission has also accepted aid schemes, not only individual measures.

The principles of the return to viability Communication formed the basis for the state aid decisions that the European Commission adopted from the autumn of 2009 onwards. Although some decisions had been taken before, such as with Commerzbank, the Commission aimed to indicate that the situation had returned to normal. In announcing the ING, KBC and Lloyds Decisions on 18 November 2009, former Competition Policy Commissioner Neely Kroes said: “We want to ensure that banks can be rebuilt so that they can play their role in helping Europe's economy to recover and will not be a long-term burden on Europe's taxpayers.” The Commissioner added that the common principles that underpin the Commission's approach to these cases were: 1) long-term business models, 2) minimisation of taxpayer burdens and 3) the maintenance of the single market. The final approval of the measures was conditional upon the presentation of a restructuring plan capable of restoring the long-term viability of the bank without continued state support.

The announcement of the Commission Decisions regarding state-aided banks seemed to have taken markets by surprise, as the stocks of the state aid banks fell considerably, depending on the scale of the restructuring plan. The share price of ING and Lloyds fell by about 30% in the week following the announcement. Markets appeared to be unaware of the Commission's powers to act on state aid, or had simply disregarded them. The Commission plan was also a signal to those banks that did not benefit from explicit government support during the crisis that the level playing field would be restored.

The agreement between the Commission and the home state of the bank in question is specific in each case. The ING announcement that it would divest all its insurance and investment management activities – and thus end its bank-insurance model – led to speculation that the Commission would impose the same conditions on other groups. In the KBC case, however, another deal was reached, including the divestment of the group's private banking and private equity business, and the sale of non-core activities in Central and Eastern Europe. In the case of Lloyds, probably one of the most difficult cases after the takeover of the bankrupt HBOS, the Commission took comfort from the sale of a part of the retail banking group.

The Commission applies the following criteria in judging each case:

- The aid must be limited to the *minimum necessary*.
- It must be *proportional* to the contribution made by private share- and bondholders. Hence, constraints are imposed on management and owners.
- The aid must be *appropriate* and *well-targeted*.
- The aid must be *remunerated*.

Applying these criteria in practice is difficult, however. What is the strictest minimum for aid? What is proportional? What conditions can be imposed on state-aided banks? As Table 2 and Box 1 below demonstrate, the European Commission has clearly applied certain principles consistently: adequate remuneration, dividend ban, price leadership ban, but the degree of downsizing and the core market reduction differs.

Table 2. Comparing specific state aid decisions of one mid-sized and five large cross-border European banks

| | Balance sheet total (€ bn) | | Burden-sharing | | Business reduction | | |
|---------------|----------------------------|------|----------------|--------|--------------------|----------------------|------|
| | 2008 | 2009 | Remuneration | Coupon | Core market | Balance sheet (in %) | Bans |
| Standard rule | | | -/+ | (-) | (-) | 50 | (-) |
| Commerzbank | 1046 | 844 | + | +/- | - | >45 | ++ |
| Dexia | 651 | 580 | + | - | + | >35 | ++ |
| ING | 1331 | 1164 | + | - | + | >45 | ++ |
| KBC | 355 | 324 | + | + | +/- | <20 | + |
| Lloyds (in £) | 1127 | 1027 | + | + | + | <20 | + |
| RBS (in £) | 2402 | 1696 | + | +/- | + | >25 | + |

Sources: Nicola Pesaresi, EU Commission; DG Competition, European Commission, *State Aid Monitor*; bank annual reports.

Box 1. Main points of state aid decisions in case of one mid-sized and five large cross-border European banks

Commerzbank

- *State aid:* recapitalisation worth €8.2 billion and a guarantee framework for securities worth up to €15 billion (October 2008), additional equity capital totalling €10 billion (January 2009)
- internal headcount reduction and restructuring/downsizing programme (45% reduction of balance sheet)
- divestment of Eurohypo by 2014 at the latest
- reduction of investment banking operations and divestment of some entities (Kleinwort Benson)
- reduced market presence in Central and Eastern Europe
- acquisition ban until April 2012
- dividend ban (2008-2009)
- price leadership ban

Dexia

- *State aid:* €8.4 billion recapitalisation and guarantee or guaranteed liquidity assistance of €95-135 billion
- domestic (life insurance business, retail branches, bond portfolio) and international (Crediop, RCB International, Dexia bank Slovakia, ...) divestment programme
- 35% reduction in Dexia's balance sheet total by end-2014 compared to end-2008
- reduction of short-term funding from 30% of total balance sheet in 2009 to 11% in 2014
- reduction of operational costs by 15% by end-2012
- dividend ban (until end-2011)
- acquisition ban (until end 2011)
- advertising restrictions
- adherence to G-20 remuneration principles

ING

- *State aid:* recapitalisation €10 billion and €12 billion of liquidity guarantees (October 2008), illiquid asset back-up facility covering 80% of a portfolio of \$39 billion (January 2009)
- internal headcount reduction and restructuring programme (45% balance sheet reduction)
- divestment of several ING insurance brands and complete separation of banking and insurance by end 2013
- divestment of ING Direct US (considered to be core by the group, but to be divested by 2013)
- divestment of new company for Dutch retail financial market (composed of mortgage and consumer credit activities)
- price leadership ban for the EU for certain retail and SME banking products for three year period maximum
- acquisition ban for three-year period maximum

KBC

- *State aid:* a recapitalisation of €3.5 billion (December 2008), a second recapitalisation of another €3.5 billion (January 2009) and an asset relief measure on a portfolio containing CDOs (May 2009)
- divestment of KBL Private Bank

- divestment of non-core activities in Central and Eastern-Europe (Serbia, Slovenia, Russia)
- divestment or scaling down a number of specialist investment banking activities, including most of the operations of the subsidiary, KBC Financial Products
- sale of several complementary distribution channels in Belgium
- focus on six home markets in bank-insurance for retail and SMEs in Belgium and five countries in Central and Eastern Europe, namely the Czech Republic, Slovakia, Hungary, Poland and Bulgaria
- scaling back a large proportion of the loan portfolios outside the home markets
- dividend, acquisition and price leadership ban

Lloyds

- *State aid:* £17 bn recapitalisation (January 2009) and £5.9 bn (November 2009)
- Asset reduction programme (£181 bn by end-2014)
- divestment programme of some brands (including TSB)
- divestment of 600 branches in England and Wales (corresponding to 4.6% market of the current account market), and behavioural constraints
- acquisition ban
- dividend ban

Royal Bank of Scotland

- *State aid:* £15 bn recapitalization and £5 bn preference shares (October 2008), converted into ordinary shares in January 2009. Further injection of £25.5 billion in November 2009, giving the state a total stake of 84%
- internal headcount reduction and restructuring programme
- large divestment programme (including RBS Insurance)
- divestment of foreign participations (e.g. Bank of China)
- sales corresponding to 25-30% of balance sheet
- 14% ceiling in SME market
- acquisition ban;
- dividend ban on hybrid capital elements

Sources: European Commission, DG Comp, state aid register, and company annual reports.

Given that each of these banks operate with different business models and in different circumstances, it is obvious that the outcome of these state aid decisions is 'tailor-made'. Commerzbank and RBS had just engaged in a large acquisition before the crisis erupted (Dresdner Bank, respectively ABN AMRO's wholesale banking unit), leading to substantial adjustments. However, the large losses were in the RBS case covered by a large shareholding of the British state, in the case of Commerzbank through a subordinated debt subscription and more limited capital injection by

Germany. In ING's case, the crisis forced it to rethink its business model, reducing complexity and to focus on its core business: banking. KBC had to reduce its number of home markets and divest its private banking; Lloyds substantially reduced its dominance in the UK market, after the forced acquisition of HBoS.

The degree of balance sheet reduction differs considerably: from less than 20% in KBC, to 45% in ING and Commerzbank. The argumentation for the large-scale reduction in ING was that the aid amounted to more than 2% of risk-weighted assets, but this was also the case for KBC and Lloyds, which were less heavily sanctioned. According to the Commission, the latter two cases were satisfactory on behavioural constraints, hence the balance sheet reduction was lower.

On several occasions, the Commission mentions that it will use the restructuring plans to increase competition in the local retail banking markets. The concentration in retail financial markets in the smaller member states is a well-known problem, which the Commission's competition policy directorate addressed in a 2007 inquiry (European Commission, 2007). Although overall the inquiry concluded that retail banking markets in the EU were only moderately concentrated, they were highly concentrated in Finland, the Netherlands, Belgium and Sweden. Increasing competition in the home market is explicitly mentioned in the decisions on ING, KBC and Lloyds as reason for requiring certain divestments.¹²

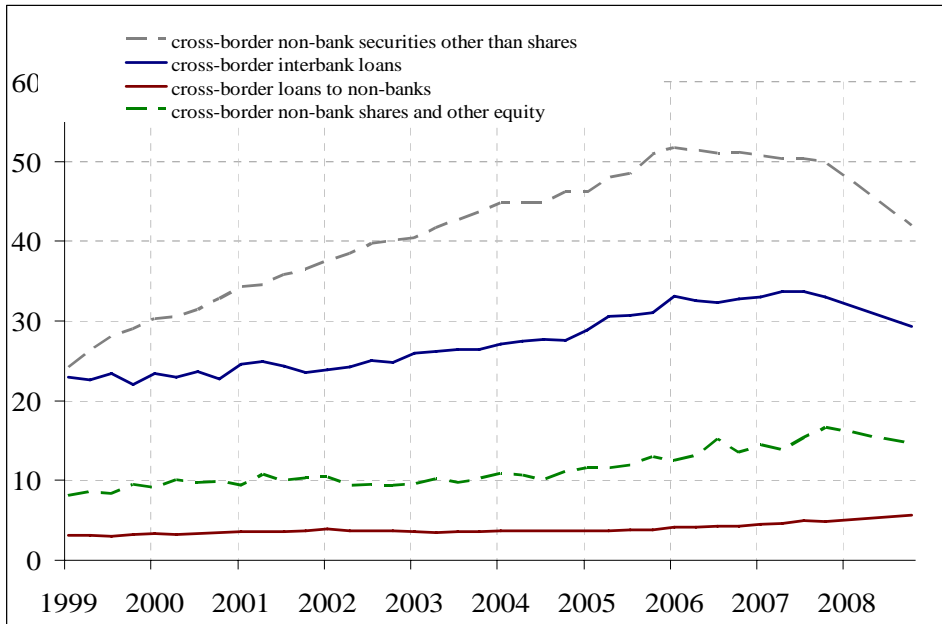
On the other hand, the European Commission's state aid unit has mandated the divestment of foreign entities of state aided banks, and the focus on some core markets, which may reduce competition at EU level. This has led to the criticism that it was acting contrary to its own objectives.

According to ECB and BIS data, market integration has receded since the crisis started. Although the situation improved from the second half of 2009 onwards, market integration indicators are not yet back to the levels they were before the crisis erupted (see ECB 2010a). A growing exposure of banks to domestic rather than cross-border counterparties is observed (ECB 2010a, p. 16). The cross-border provision of financial services, in the

¹² Explicitly mentioned in the press releases on ING and KBC, European Commission, 18 November 2009.

interbank market and corporate securities markets, has declined significantly since 2007, although the effect of reduced financial market intermediation has to be taken into account (see Figure 3).

Figure 3. Cross-border provision of financial services in the euro area



Source: European Central Bank.

It could be argued that the Commission is measuring competition at national level, not at European level. The French refinancing scheme, created in October 2008, was cleared the same month by the Commission, who judged that the scheme was an appropriate, necessary and proportionate means of remedying a serious disturbance in the French economy. The Commission authorised it as it gave non-discriminatory access for all banks authorised in France, including the subsidiaries of foreign groups; it included a pricing mechanism that covered the funding costs of the scheme and ensured a fair contribution by the beneficiary banks, and it had appropriate safeguards against abuse of the scheme. The same happened with the recapitalisation scheme, which was authorised by the European Commission on the same grounds. Under the SPPE (*Société de Prises de Participation de l'Etat*) structure, the state invested in securities issued by the beneficiary banks. These securities took the form of hybrid

capital instruments (subordinated debt securities classified as non-core Tier 1 capital) and were remunerated at a fixed rate for the first five years and at a variable rate thereafter. The remuneration, which averaged about 8%, reflected the degree of solvency of each beneficiary bank via a credit default swap (CDS) component, whereby remuneration is modulated according to the risk of default. All large French banks benefited from the scheme, but it did not lead to any specific demands on the banks involved.¹³ Only one French bank was the subject of an individual state aid procedure, the Banque Populaire/Caisse d'Épargne, which benefited from €2.45 billion government aid, on top of that already granted under the French scheme. But also that case was cleared by the European Commission without further restructuring demands.¹⁴ This compares to 13 individual bank cases in Germany, some of which are still under in-depth investigation, and much deeper restructuring demands.

It should thus come as no surprise that some states felt unjustly treated, leading to criticism of arbitrariness and inflexibility in the decisions. In January 2010, ING lodged an appeal with the European Court of Justice against specific elements of the EC's Decision of 18 November 2009. ING objects to the price leadership restrictions and the proportionality of the restructuring requirements demanded by the European Commission. In addition, the Commission judged that the early repayment by ING to the Dutch state of the first tranche of the subordinated debt as additional state aid of approximately €2 billion. Both ING and the Dutch state contest this element of the Decision.¹⁵ The Commission argues that early repayment would distort the level playing field again.

Effects of state aid and exit strategies

Overall, state aid was, in combination with the monetary policy and financial market stability measures, successful in preventing a collapse of the financial system. The impact on individual banks is, however, less clear

¹³ See cases 613/2008 (recap) and 548/2008 (refinancing) in the European Commission's state aid register.

¹⁴ Case N249/2009.

¹⁵ See ING 2009 Annual Report, p.12.

cut. Different indicators can be used, which point in different directions. In general, the share price of most state-aided banks declined, reflecting a dilution of shareholders' earning rights and raising concerns about banks' long-term profitability. In addition, the Commission has set very tight criteria for state aid, which negatively impact the future growth plans of the banks in question.

The premia on credit default swaps (CDS) for large banks, on the other hand, fell with the announcement of system-wide rescue packages, and especially with the announcement of capital injections. Bank CDS premia demonstrated a further reduction when the government measures were actually implemented. According to research by the BIS (2009), the reduction of default risk is correlated with the amount of resources pledged, in particular with the size of capital injections.

Rating agents see a positive effect of the state support schemes on bank lending and liquidity, but indicate that they failed to stimulate lending. They see a large proportion of the banks currently on their support floor, but weakening of the support will result in further downgrades, unless the bank has returned to intrinsic health. In addition, refinancing needs will remain high until 2012, boosted by the introduction of tighter capital requirements (Fitch, 2010).

Each European government that provided state aid to a financial institution affirmed that the measure was temporary, and that the ultimate goal should be to return banks completely to the private sector. This, however, throws up questions about when and how governments should re-privatise financial markets and banks. To answer this question, one must assess both the nature of the state aid offered as well as the objectives of the governments providing state aid.

Government guarantees: In principle, government guarantees should be self-liquidating. Considering this, the primary question is when governments should stop providing banks with guarantees. Should governments be allowed to issue guarantees up to the date agreed with the Commission, or should governments stop granting state aid before that date assuming markets stabilise?

Recapitalisation and bad banks: As this form of state aid involves an actual transfer of government funds in exchange for shares, it must be determined when governments should sell shares back to the private market, or write them off. To answer this question the following trade-off must be considered: should the government seek to make a profit from the

purchased shares or should it dispose of shares as soon as the market has stabilised? (See Annex 4 for examples of European Bad Bank Schemes).

Nationalisation: Governments can transfer a nationalised bank to the private sector in two main ways: through sales in the stock market; or via a private placement of bank equity stakes (i.e. either by selling all or part of the bank to an existing bank, or selling directly to institutional investors). A more important question is whether a government should use its power as shareholder to restructure the bank first. Restructuring could involve narrowing the bank's operations, splitting or separating banks and insurers, or imposing mergers.

Formally, however, it should be kept in mind that there is no obligation on states to re-privatise, unless this would have been agreed in the context of a state aid procedure. The EU Treaty is neutral as regards the form of ownership. But the state capital has to be remunerated according to market standards.

Overall assessment of the EU state aid policy during the crisis

The containment of the financial crisis was the result of a vast comprehensive effort by governments, central banks and international authorities. Measures to stabilise the financial sector and support the economy taken at EU and national levels have benefited all financial players and economic actors. But some financial institutions or sectors were in need of more substantial support.

The direct state support happened in a very disparate and non-coordinated matter, however, in contrast to what the Eurogroup meeting of 12 October 2008 had affirmed. Many member states chose to call upon a national scheme to support the entire financial sector, but the schemes varied widely in scale and scope. In other cases, states provided support to individual banks, or through a combination of both. In addition, the quality of sovereign guarantees differed significantly, thus favouring 'weak' borrowers with a 'strong' sovereign backing, or disadvantaging 'strong' borrowers with a 'weak' sovereign backing.

Seen in hindsight, comprehensive national support *schemes* raised much less of a competition policy problem, as they provided support for

the whole banking sector in a certain country.¹⁶ The French scheme is a case in point, since it was imposed on all the large banks, and rapidly got the blessing of the EU, as it was non-discriminatory. In other countries, the problem with some banks was much more acute, and required direct state support, often in addition to a national scheme. The end-result is that some banks ended up in a tight restructuring and downsizing plan imposed by the European Commission, whereas others have fared almost unaffected. Another result of these differences in national policies is that the banking landscape will emerge entirely reshaped after the crisis.

The question whether the single market was maintained seems almost rhetorical in this perspective. Several banks start on a much more uneven playing field since the crisis than before it. To some extent, there is only the bank and its management to blame. But national policy-makers could also be criticised for their limited knowledge of the EU's state aid rules, for their incapacity to put together a comprehensive support plan, and for not having reacted rapidly enough.

¹⁶ See also Boughdene et al. (2010), who come to the same conclusion in an overview regarding asset relief measures in the EU.

II. THE EVOLUTION OF EU BANK STATE AID PRACTICE IN THE CURRENT ECONOMIC AND FINANCIAL CRISIS

Background

The purpose of this chapter is to provide some legal, institutional and procedural background to the cases of state aid in the banking sector. EU state aid procedures are far from being well-known to economic actors, especially in financial services sector where, historically, EU state aid rules have been less frequently applied.

The fact that more than 60 cases (both schemes and individual bank cases) have been dealt with by the European Commission over the last two years alone means that this crisis will be a landmark in EU state aid law and policy. Whether or not the Commission's final decisions are contested in the European Courts, the Commission's successive Communications (even if these are 'soft' rather than 'hard' law) taken together with the final decisions themselves, will constitute a precedent and a body of practice that are likely to endure for many years to come.

Despite the unprecedented scope and gravity of the current banking crisis, it is remarkable that the European Commission has been able to deal with the cases referred to it very much as 'business as usual', applying – broadly speaking – the well-established principles of rescue and restructuring aids, adopted for the banking sector.

One important question raised in this chapter, however, is whether this approach was (politically, economically and legally) appropriate (or at least *sufficient*), given the gravity of the current crisis and its global dimension.

Two questions in particular arise here. Although the ECOFIN Council confirmed in early 2008 that state aid disciplines should be followed as regards the recapitalisations, bail-outs and guarantees made available to banks by almost all member states, the Commission's state aid procedures not only exclude other EU institutions (e.g. the Council, the Parliament and the ECB) from participation in the process, but also the other departments of the Commission, such as DG MARKT, DG ECFIN and DGs Trade and ReLex.

Given the interconnection between the 'aid' or 'subsidy' aspect of the banking crisis and the macro-economic, monetary, fiscal and regulatory/supervisory dimension (all of which fall outside the exclusive competence of the Commission), there appears to be a strong case for ensuring that the current Commission state aid procedures are, at some stage, reviewed 'holistically', with the possibility of adapting individual decisions to ensure that the European banking industry *as a whole* (and the embryonic single European financial services market) emerges strengthened and more competitive from this crisis.

Secondly, the state aid procedures will obviously not resolve the banking crisis in the EU, taking sufficient account of comparable action (or lack thereof) being taken by other jurisdictions, such as the United States. Given the global nature of capital markets and the growing importance of the G20 and institutions such as the IMF and FSB, it appears vital that the EU's approach is *not* confined to a case-by-case analysis on the basis of wholly internal rules, even if this approach is intended to produce viable banks without the need for further aid and a more competitive European market place.

It would be unfortunate, to say the least, if the Commission's final decisions in these cases were to be the subject of prolonged litigation in the European Courts. With the exception of the recent cases brought by the Netherlands and ING, there are no indications that this is likely to be the case. Nonetheless, given the need for stability and legal certainty for banks and their customers (as well as financial markets and the economy in general), early political and legal 'closure' of the current cases (preferably by the end of 2010) is in the interests of all.

The general approach followed in the EU

Despite the unprecedented severity of the current financial crisis, the European Commission – supported by all member states in the Council –

has followed a ‘classical’ approach in the cases that it has examined. It has applied the provisions of Articles 107-109 TFEU, taking into account ‘guidelines’ set out in a number of non-binding Commission communications, covering general principles, recapitalisation, impaired assets and restructuring aids (see below).

EU state aid law and procedure is, on the whole, less well-known than (for example) general EU competition law. In particular, state aid *procedures* contain a number of particular (and controversial) features, which require explanation. In particular, despite the emphasis (understandably) placed by the Commission on ‘transparency’, state aid procedures are in fact far from transparent for those (mainly private sector) interests not directly involved in the case being investigated by the Commission. Current state aid procedures fall far short of meeting all the requirements of ‘due process’.

These procedural deficits are of particular importance in a situation where the Commission has initiated proceedings in over 100 cases, involving almost all member states in a little over two years and where a decision in one case may have a significant impact on other banks, other member state markets and even – for pan-European banks such as ING, KBC and Lloyds, for example – the EU market as a whole. Full transparency is crucial for comparability and consistency. It is not (yet) clear that these principles have been fully respected in the current process.¹⁷ In any event, any discussion of the individual cases considered by the Commission in this banking crisis requires a short summary of relevant EU state aid law and procedures.

EU state aid rules applicable to banks

EU state aid rules are set out in Articles 107-109 TFEU. Procedural rules for state aid were consolidated in Regulation 659/1999. As in other fields, such as competition policy, the relevant Treaty rules are relatively short and simple, leaving ample room for interpretation by the European Commission (“administrative discretion”) and by the European Courts.

¹⁷ Given the restrictions inherent in the current rules as set out in the Treaty and in Regulation 659/1999, it may be impossible to meet these criteria unless the rules are amended or a different approach is conceived to take account of the unique nature of this banking crisis.

State aid is defined in Article 107(1) in broad terms as being:

- granted by a member state or through state resources in any form whatsoever;
- that distorts or threatens to distort competition;
- that favours certain undertakings or the production of certain goods (the “selectivity” test); and
- that affects trade between member states.

These ‘elements’ of state aid are *cumulative*; in the absence of any one of them, a measure does not constitute “aid” within the meaning of Article 107(1).

Illegal and incompatible aid

EU law distinguishes between aid that is “illegal” and aid that is “incompatible with the internal market”. The former is generally considered to be aid that has been implemented by member states without having been notified in advance to the Commission in accordance with Article 108(3) TFEU.¹⁸ The ‘sanction’ for non-notification is an order by the Commission for mandatory recovery of non-notified aid, together with compound interest from the date of granting the aid. It is an indication of member states’ willingness to work constructively with the Commission in the current unprecedented crisis, that there are apparently no cases of non-notified (illegal) aid currently being investigated. At least therefore, the additional threat of recovery of illegal aid does not hang over European banks, at least on the assumption that the European Commission has now been notified of all aid measures.

Aid that is “incompatible with the internal market” is aid that distorts competition and trade. Article 107(2) and (3) lists categories of aid that either *are* to be considered compatible with the internal market (social aid, aid to repair natural disasters and aid to compensate for the division of Germany)¹⁹ and aids that *may* be considered (by the Commission) to be

¹⁸ “The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid.”

¹⁹ This paragraph is not relevant to the decisions taken by the Commission on state aid to banks.

compatible with the internal market. Two categories of the latter in particular are important in the field of banking state aid. These are:

- “aid ... to remedy a serious disturbance in the economy of a Member State” (Article 107(3)(b)); and
- “aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest” (Article 107(3)(c).

One crucial development in the current crisis situation has been the decision by the Commission, at an early state, to base its consideration of compatibility on the (arguably more flexible) criteria in Article 107(3)(b). Historically, this provision had rarely been used, mainly because of the strict interpretation given to the concept of “serious disturbance in the economy of a Member State” by the Commission and by the Court. The Commission’s position on the use to be made of Article 107(3)(b) was that it cannot be extended to other sectors.

In practice, given the European Commission’s dominant role in interpreting the criteria for compatibility (at least in the absence of European Court rulings), - and the fact that the Commission now applies comparable rescue and restructuring aid guidelines to banks under Article 107(3)(b) as it did to industry under Article 107(3)(c) - there may be little significant difference between the approach under paragraphs (b) and (c). Even under the (allegedly) non-flexible paragraph (b), the Commission insists on compliance with the rescue and restructuring guidelines (published, for banks, in August 2009), by close analogy with practice under the “industrial” rescue and restructuring guidelines, adopted to give effect to Article 107(3)(c).

The Commission’s exclusive role in deciding issues of compatibility

It is important to note that the Commission *alone* has the authority under EU law to decide whether or not national aids may be considered to be compatible with the internal market under Article 107(2) or (3).²⁰

²⁰ It is unclear to what extent, at any stage of state aid proceedings, *serious* consultations are held between DG COMP and other Commission services with a

Commission decisions on compatibility of incompatibility are subject to judicial review by the European Courts under Article 263 TFEU, on the application of a member state or – subject to specific conditions – by a private party. In contrast, national courts may interpret and apply those parts of Articles 107-109 that have direct effect in national law. In essence, these are the definition and general prohibition on aid in Article 107(1) and the prior notification requirement in Article 108(3) (first sentence). National courts are *not* competent to decide issues of compatibility.

The relative simplicity of the relevant Treaty rules and the authority granted to the European Commission to interpret and enforce these rules undoubtedly confers extraordinary responsibility on the Commission, especially in the current economic and financial crisis, in terms of ‘administrative discretion’, particularly on issues of compatibility. It is significant that member states in the European Council (and, more specifically, in ECOFIN) have consistently confirmed and supported Commission action on state aid in the current crisis, notwithstanding the political sensitivity and technical complexity of the issues involved. Thus, no action has been taken under Article 109 TFEU by the Council (after consulting the European Parliament) to exempt particular categories of aid (e.g. aids to banks in the current crisis) from state aid procedures.

Limited judicial review in the European Courts

The broad administrative discretion enjoyed by the Commission in this field is subject to judicial review by the European Courts, notably under Article 263 TFEU (“actions for annulment”). However, in addition to the procedural limitations imposed by this Article (particularly for actions by private parties),²¹ judicial review is tightly circumscribed, compared with

legitimate interest in the restructuring of the European banking industry as a whole.

²¹ Private parties, such as banks, must demonstrate that actions they may bring against the Commission are “admissible” within the meaning of Article 263 (fourth paragraph): “any natural or legal person may, under the conditions laid down in the first and second paragraphs, institute proceedings against an act addressed to that person or which is of *direct and individual concern* to them, and against a regulatory act which is of direct concern to them and does not entail implementing measures” (emphasis added).

the situation in many member states (e.g. the UK). The European Courts are reluctant to duplicate the economic analysis and assessment made by the Commission (for example on compatibility or incompatibility of state aid with the internal market), limiting their judicial review to ensuring or to checking whether the Commission has made “a manifest error of appreciation” in its economic assessments.

Although there is a certain subjectivity to the concept of “manifest error of appreciation”, it is clear that the European Courts will not overturn Commission decisions in the banking sector lightly, especially where these have involved highly technical assessments, conducted in close cooperation with the member state concerned and after having taken into account submissions by the private sector in response to Commission notices opening the investigation procedure.²² In addition, as is apparent from the decisions that have been published on aids to banks, the Commission’s practice is now to take comprehensive and tightly-reasoned decisions (doubtless assisted by the presence of a Chief Economist’s department in DG COMP), which are less likely to be overturned on appeal by the European Courts.

The need for legal certainty for banks, customers, public authorities and markets

Legal certainty is a crucial factor for all concerned with Commission state aid procedures. This is particularly the case in the extreme conditions of the crisis, which have afflicted governments, the financial sector, the economy as a whole and indeed citizens over the last three years. The degree of administrative discretion possessed by the Commission (particularly as regards the fixing of compatibility criteria and the subsequent assessments of compatibility) and the limited scope of judicial review as described above do not necessarily facilitate legal certainty.

Undoubtedly, the successive Communications published by the Commission on banking state aid between October 2008 and August 2009 (covering general principles, recapitalisation, impaired assets and restructuring aid) assist all parties concerned in understanding the

²² It is not obvious from the relatively few decisions that have been published whether *any* third-party submissions have been made in current cases.

Commission's methodology in the cases it is handling. Although they are non-binding ('soft law'), these Communications constitute an authoritative guide (for member states, banks and the European Courts) to the Commission's methodology and would certainly be taken into consideration by the European Courts in exercising their judicial review function. The broad principles contained in all the Commission's Communications on banking state aid are summarised below.

More generally however, Commission state aid procedures fall far short of affording "due process", especially as far as private sector interests are concerned. In general, state aid cases are conducted between the Commission and the member state concerned. In strict legal terms, *all* state aid must be notified in advance of their implementation to the Commission in order for it to be able to assess the compatibility of the aid with the internal market. If the Commission considers that the proposed aid is, *prima facie*, incompatible with the internal market, then – in accordance with Article 108(3) TFEU "it shall without delay initiate the procedure provided for in paragraph 2." No such procedures are prescribed for aids that may be considered by the Commission to be *compatible* with the internal market. This does not mean that Commission decisions approving aids may not be challenged under Article 263 TFEU, but the fact that the Commission's legal and economic reasons for approving the aid are not published in full places a handicap on member states and competitors wishing to challenge such decisions.

When the Commission opens an investigation into a proposed aid which it considers, *prima facie*, to be incompatible with the internal market, the Commission publishes a notice inviting third parties to submit their comments, in accordance with Article 108(2) (first sentence). Neither the Treaty nor the Council Regulation consolidating certain procedural aspects of state aid investigations²³ provide any legal basis for 'hearings' by the Commission, either for recipients of aid or their competitors.

In practice however, the Commission's services are generally willing not only to receive written submissions by interested third parties, but also to hold meetings. This tends to be the case with aid recipients in particular, but also with competitor enterprises adversely affected by the proposed

²³ Regulation 659/1999 (OJ L 83 of 27.3.1999).

aid. In the current banking state aid cases, for example, member states have frequently been accompanied in their meetings with the Commission by representatives of the banks in question. However, it is important to underline that this is merely at the discretion of the Commission and the member state concerned.

The usefulness of the ‘rescue and restructuring aid’ formula in the present banking cases

In the cases that it has handled over the last two years or so, the Commission has been required to act under severe time constraints. The ‘price’ that has had to be paid for continuing to deal with all banking state aid cases under ‘conventional’ EU state aid law has been for member states’ notifications of proposed aid to be vetted by the Commission, sometimes within days or over a weekend, in order to preserve – to the maximum extent possible – market stability.

In the vast majority of cases, the Commission ‘approves’ such notifications, albeit on a provisional basis, categorising the measure(s) in question as a ‘rescue’ aid and requiring the member state to revert to the Commission – usually within six months – with a plan for the restructuring of the bank, aimed at ensuring its long-term viability without further aid.

In industrial sectors, the Commission has for many years applied specific rules on “rescue and restructuring” aids, based on a methodology laid down in a Communication published in the Official Journal.²⁴ Despite initial hesitations as to whether the principles applicable in industrial sectors could be applied to financial services (especially banking), the Commission has (so far successfully) approved notified aids very quickly as ‘rescue aids’, with the proviso that the member state concerned submit – normally within six months following the rescue aid decision – a restructuring plan to the Commission for the bank in question. On the basis of this plan – and after discussions with the member state in question²⁵ – the Commission could issue a final decision approving the aid in question,

²⁴ OJ C 368 of 23.12.1994, p. 12.

²⁵ As a matter of practice – though not legal obligation – such consultations usually involve the aid recipient, especially if restructuring measures need to be agreed, which will be implemented by the economic operator in question.

either with or without conditions attached. The relatively recent Commission decisions in cases such as KBC, ING and Lloyds were all taken on the basis of this ‘formula’.

State aid: ‘Business as usual’ despite the gravity of the current crisis?

There is little doubt that the European Commission’s application of the state aid rule during the current economic and financial crisis is without precedent in the history of the EU.²⁶ The economic and financial significance of the amounts of aid involved, the fact that virtually all member states are affected (though to different degrees and in diverse ways) and the sheer number of individual cases dealt with by the Commission, all set this situation apart from others dealt with by the Commission over the last 50 years.

In terms of political sensitivity, financial and economic importance and technical complexity, there are many similarities (as far as state aid is concerned) between the current banking cases and the approach followed over the last 12 years in the field of direct taxation. In both areas, notwithstanding the fact that national vital interests at the core of state sovereignty have been at stake, member states have decided unanimously in the Council actually to encourage the Commission to “take its responsibilities under the Treaty” and to apply and enforce relevant rules. In both cases, it would have been possible – certainly politically but also legally – for the member states in Council to have insisted on action being taken exclusively in the Council, for example on the basis of an agreed policy framework under legislation adopted on the basis of Article 109 TFEU.²⁷

²⁶ One possible analogy is the steel crisis of the late 1970s and early 1980s. However, that *sectoral* crisis involved a combination of *internal* EU measures (including state aid and a quota-system) and *external* measures (e.g. dumping duties, export understandings and import quotas) covering trade with third countries.

²⁷ Private conversations with Commission officials confirm that the ‘conventional’ application of EU state aid rules and disciplines was, *by no means*, to be taken for granted given the gravity of the present crisis. It may be thought extraordinary that, notwithstanding the primacy of *national* economic and political concerns in

Instead, both in direct taxation and in the financial services (mainly banking) sectors, the Commission has:

- acted autonomously in accordance with its ‘classical’ role in the state aid field under Articles 107-109 TFEU;
- developed its approach pragmatically through non-binding Communications, setting out (for the benefit of member states and the private sector alike) its intended approach under the fundamental Treaty provisions;²⁸ and
- made maximum use of the flexibility inherent in the Treaty, especially the “derogations” allowed under Article 107(3) (a)-(c); successfully avoided – for the most part at least – reaching decisions that member states and economic operators feel compelled to refer to judicial review in the European Courts.

At a time of significant political and institutional change (notably through the ratification and implementation of the Lisbon Treaty) and when fears existed concerning the potential ‘re-nationalisation’ of some areas of EU policy, the Commission’s success in preserving its ‘competence’ not only to deal administratively with so many cases affecting virtually all member states, is remarkable and reflects considerable credit on the first Barroso Commission (especially Commissioner Kroes, her Cabinet and services).

The gravity of the current economic and financial crisis is such that, in the early stages at least, it was not inconceivable that matters might have been taken out of the hands of the European Commission, for example by a

financial sectors, member states continue to perceive an interest in a form of independent ‘third party’ rule-based application on such sensitive matters as banking and direct taxation.

²⁸ The publication of detailed interpretative guidelines, in the form of non-binding Communications, is of course a well-established Commission practice in the field of state aid. Such guidelines fulfil at least three purposes: i) informing donors and recipients of aid (as well as competitors) of the approach the Commission intends to follow in applying the basic Treaty rules; ii) maintaining, nonetheless, a significant measure of flexibility in the detailed application of the guidelines on a case-by-case basis; and iii) assisting the European Courts in their judicial review function.

decision of the Council acting under Article 109 TFEU,²⁹ establishing an *ad hoc* procedure for this unprecedented situation. Instead, the Commission responded – both on substance and in terms of its internal organisation – in a way that appears to have retained (at least in very broad terms) the confidence and respect of both member states and private sector alike.

The Commission's Communications on state aid in the banking sector

As indicated above, the Commission has provided guidance to member states and the private sector by means of a series of Communications of a general and specific nature, dealing with issues such as general principles of state aid law in the banking sector, recapitalisation, impaired assets and restructuring aids. These Communications have been cumulative and pragmatic, in the sense that they have provided an evolutionary but consistent response to the crisis as it has unravelled. Although these Communications are legally non-binding, they do aim to give an authoritative indication of the Commission's approach in this particular area.

The Communications are as follows:

- the application of state aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (OJ C 270/8 of 25.10.2008);
- the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards in undue distortions of competition (OJ C 10/2 of 15.1.2009);
- the treatment of impaired assets in the Community banking sector (OJ C 72 of 26.03.2009); and
- the return to viability and the assessment of restructuring measures in the financial sector (OJ C 195/9 of 19.8.2009).

It is not appropriate here to attempt to summarise all four Communications (see Annex 3). There are however a number of *general*

²⁹ "The Council, on a proposal from the Commission and after consulting the European Parliament, may make any appropriate regulations for the application of Articles 107 and 108 and may in particular determine the conditions in which Article 108(3) shall apply and the categories of aid exempted from this procedure."

themes that characterise the Commission's approach as a whole. These include:

- the need to distinguish between 'good' and 'bad' banks, with the latter suffering greater restructuring and compensation measures or even winding up, compared with banks that have been prudently operated;
- all aid must be well-targeted, proportionate and minimise negative spill-over effects on competitors, other sectors and other member states;
- aid must be limited to the minimum and the private sector must contribute its fair share to restructuring ('burden-sharing');³⁰
- aid schemes should be limited in time with mandatory periodic reviews;
- the need to ensure 'no aid' to buyers of liquidated financial institutions (sales process to be opened and non-discriminatorily, on market terms, with a maximum sale price for assets on liability involved);
- a clear distinction should be made between 'normal' liquidity provided by central banks in the form of general measures open to all comparable market players, compared with support for specific financial institutions;
- all aid measures and restructuring plans should aim at restoring long-term viability, without the need for further injections of aid; and
- all EU aid measures and decisions should aim at ensuring a competitive European banking sector in a global context.

³⁰ For example, as regards guarantee schemes, beneficiary financial institutions should be required to make adequate remuneration "as close as possible to what could be considered in market price", the private sector should cover "at least a considerable part of the outstanding liabilities incurred by the beneficiary undertaking, with member states' intervention being limited to amounts exceeding the contribution"; if institutions are unable immediately to pay appropriate remuneration, claw back clauses could be considered.

Transparency, comparability and consistency

Inevitably, in state aid cases, the Commission is obliged to take a case-by-case approach as member states notify it of individual aids or aid schemes on a case-by-case basis. In the present situation, where the vast majority of member states have granted state aid to their banks or other financial institutions, it is however crucial, in the interest of preserving a genuine Single Market and avoiding fragmentation, that the approach taken by the Commission be consistent and that – to the extent possible – the overall ‘package’ of decisions at least does not ‘freeze’ a situation of market fragmentation caused by the fact that, for the most part, the response to the present banking crisis has almost exclusively been in the form of *national* measures. It is of course premature to decide whether the Commission’s approach is likely to achieve this ambitious goal, since many final decisions have yet to be taken.

In addition, although a ‘case-by-case’ approach is unavoidable, it is important that the ‘autonomous’ state aid decisions taken by the Commission be consistent with policy decisions taken in other fields, including monetary, macro-economic and fiscal policy, as well as regulatory and supervisory measures affecting banks (e.g. in the pending revisions to the Capital Requirements Directive). Given the way in which state aid decisions are taken within the Commission (and in particular the relative autonomy of DG COMP), it is not at all clear that the decisions now being taken are subject to sufficient coordination with other Commission departments or indeed to consideration in the ECOFIN Council. It also appears that the ECB and the European Parliament have only played a very limited role in the Commission’s ‘management’ of the aids aspects of the current crisis.

Commission decisions in particular cases

Until a broad cross-section of final decisions has been published by the Commission in the Official Journal, a full comparative analysis of the Commission’s decisions will be impossible. However, from available information (notably concerning the three major decisions taken by the Commission so far on KBC, ING and Lloyds), it appears that the Commission has followed the principles set out in its Communications, but has done so with significant differences of analysis – between the Belgian, Dutch and UK cases, for example. Thus, even if the individual decisions taken by the Commission are defensible within the Treaty context, it is not

obvious that – in taking these decisions – the Commission has taken into account the overall structure and competitiveness (both internally and externally) of the European banking sector, as should be demonstrated over time from the impact of the decisions in question.

Broadly speaking, in all three cases, substantial amounts of aid have been approved subject to onerous ‘offset’ structural and behavioural obligations such as divestments, remuneration obligations, bans on acquisitions, etc. It is however difficult to compare the structural and behavioural elements of the Commission’s decisions in these three cases and, perhaps above all, to check the overall effects of the Commission’s decisions in these major cases on the EU financial services market as a whole.

One important distinguishing factor in the Lloyds case, for example, is the fact that even after completion of the restructuring, the UK government will still hold 42.5% of the shares in the Lloyds Banking Group (LBG), which is the consequence of the aid granted to the bank in 2009. It appears that the Commission decision on Lloyds does not address the issue of ‘unwinding’ state support for the bank, even if LBG’s divestment obligations are substantial – including branches, staff, customers, customer accounts and support infrastructure for, inter alia, the TSB brand, the Cheltenham & Gloucester entities, the Lloyds TSB Scotland branches, as well as supplementary branches in England and Wales, and the direct bank Intelligent Finance.

Although the discussion between member states and the Commission appears to have been largely cooperative and constructive, there are indications that – in certain cases at least – certain banks and member states may consider that their treatment has been inequitable or even illegal, either intrinsically because of incompatibility with EU law or comparatively, in relation to the treatment of other banks, including those in key member states such as France.

Perhaps more importantly (as discussed below) member states may take the view – in due course when the overall picture of the restructuring measures taken on a case-by-case basis by the Commission becomes clear – that the Commission has exceeded its powers under the Treaty by engaging, in effect, in industrial restructuring, rather than the resolution of individual aid cases. As far as ING is concerned, the Commission quite openly states that, amongst recent cases, ING has received the highest amount of aid and has a strong position on current accounts in the Dutch

retail market. However, the Commission states that the divestment package agreed with the Dutch authorities is relatively small in its core market but compensated by large divestitures in other key business units, such as the entire insurance business, ING Direct US, asset management and private banking.

As far as KBC is concerned, the Commission states that total divestitures contained in the KBC restructuring plan are less extensive, but are compensated by the high price paid by the bank for the aid and the high quality of the divestment package. Similarly, for Lloyds, the Commission justifies the lower level of divestitures compared with ING by saying that it is of high quality and constitutes an attractive business proposition for a new entrant on the concentrated UK retail banking market.

The Netherlands / ING action in the European Courts

On 28 January 2010, ING launched proceedings against the Commission, seeking the partial annulment of the Commission's Decision of 18 November 2009 insofar as it qualified the Core Tier 1 capital transaction as aid to the amount of €2 billion, and that the Commission subjected the approval of the aid to the acceptance of price leadership bans and to restructuring requirements going beyond what is proportionate and required under the restructuring Communication. In this respect, as regards infringements of the principles and guidelines set out in the restructuring Communication, ING asserts that the Commission made an error of judgement in wrongly calculating the absolute and relative aid amounts, requiring excessive restructuring without carefully and impartially examining all the relevant facts provided to it, thereby deviating from the principles set out in the restructuring Communication.

On the same date, the Netherlands also instituted proceedings against the Commission on the grounds that the Commission's finding that the modifications of the repayment terms in respect of €5 billion of capital injection involved state aid. More specifically, the Netherlands authorities appear to make an identical submission to that of ING, arguing that the Commission's conclusion that the modification of the repayment terms concerning the holding in the core capital of ING constituted €2 billion of additional state aid, was erroneous. According to the Dutch Government, the Commission should have included the modification of the repayment terms in its overall appraisal of the shareholding in the core capital, rather than carrying out a separate analysis. In essence, the Dutch authorities

appear to argue that the modification of the repayment terms did not constitute state aid because it tended to ensure a better reflection of the market economy principle in the package as a whole.

It remains to be seen whether other banks and member states will take the same course as the Netherlands and ING and contest the Commission's final decisions before the European Courts.

Does the Commission's approach to banking state aid constitute industrial policy in disguise?

Certainly, the restructuring ordered by the Commission in the ING, KBC and Lloyds cases is radical by any standards, even if – at least in very broad terms – it is based on proposals worked out between the financial institutions and the Member States concerned. The Commission itself has stated that many if not all divestments have been proposed by the banks themselves and that there is at least the assumption that there will be sufficient market interest in the divested activities.

The European Commission's approach does go further, however. The Commission openly admits that its restructuring Communication requires an examination of the structure of the market on which the banks operate. In the case of KBC, ING and Lloyds, the Commission finds that in each of the three domestic markets involved, the top five banks occupy around 80% of each market. The Commission therefore concludes that:

the divestments in question will therefore create opportunities for new entrants or already present smaller players and will therefore remedy any distortions of competition caused by the state aid.

This seems, at the very least, a bold assumption. Of course, all Commission decisions on competition policy in its widest sense (antitrust, monopolies, mergers and state aid) to a certain extent 'shape' the market in question. The present exercise is likely to take this process to unprecedented lengths, for example (arguably) by reversing (at least partially and for certain financial institutions) the trend to the conglomeration of financial services in single institutions.³¹ It is at least

³¹ The Commission has stated that it does *not* "have a preference for one business model over the other. It will assess, on a case by case basis, whether an adjustment of the business model of the bank in question is necessary." It is surely

questionable whether such decisions should be taken by an unelected Commission acting under Treaty provisions that exclude cooperative action within the Council, consultation with a directly-elected Parliament and with input from the ECB with its overall responsibility for capital markets in the eurozone.

It has to be kept in mind that these legally binding decisions by the Commission are of a completely different character to action being taken in other capital markets around the world, notably the United States, Japan, and other G20 countries. The Commission asserts (see below) that the individual banks and the European banking industry will emerge stronger from this process and will therefore be better able to compete on world markets. However, this may not be immediately apparent to the ‘victims’ at this stage in the process.

As indicated above, by necessity, the Commission has to conduct state aid investigation on an individual, case-by-case basis. On the other hand, in the current crisis, a number of member states appear to have been more successful than others in presenting schemes or the restructuring of their banking sectors as a whole, without singling out individual banks, as has been the case for ING and KBC, for example. It is true that the Commission has applied the same principles to all banks receiving restructuring aid, notably those set out in the restructuring Communication of 22 July 2009. Thus, in all cases, the Commission requires that:

- The bank will be viable under reasonable stress assumptions without further injections of taxpayers’ money in the future;
- That the banks contribute a significant proportion of the cost of its restructuring via the sale of assets or other means; and
- That competition distortions created through the aid are sufficiently addressed through relevant reductions of activities.

unprecedented for the Commission to take responsibility for dictating the ‘business model’ of private enterprise in the EU, even in the name of ensuring fair competition. The Commission justifies its approach on two grounds: first the need to ensure consequences for past errors (moral hazard) and secondly the need to guarantee a “strong presence of the bank”. The Commission asserts that: “in all cases the Commission makes sure that the viability of the bank is given priority, so that divestment and other behavioural measures limit the competitive distortions without endangering long- term viability”.

It is not immediately apparent however how the Commission can apply point three above without having an overall view of the European banking market as it emerges from the crisis and taking into account the restructuring measures imposed by the Commission. This immediately raises the institutional question of how these state aid decisions are taken within the ‘college’ of 27 Commissioners and based on the full consideration and consultation between the relevant services.

In any restructuring of the European banking market to ensure that it emerges stronger and more globally competitive from the current crisis, one would assume that – at the very least – the commissioners for economic and financial affairs on the one hand and the internal market on the other, together with their services, would have contributed to these decisions. It is not clear that this is the case.³²

In addition, notwithstanding the apparent confidence vested by the member states in the Commission in this exercise, it seems strange that neither the member states (nor, for example, at least as regards eurozone member states and banks, the European Central Bank) have participated in this exercise, other than on an individual basis.³³ Of course, it may be argued that if such an approach had been followed, decision-making would have been infinitely complicated. It was more expedient (in addition to being consistent with EU law) to ‘delegate’ the task of restructuring the European banking industry to the Commission.

However, such a task goes far beyond the Commission’s ‘mandate’ under the Treaty. It is of course arguable that the Treaty is silent on industrial restructuring and that the state aid instrument is the only mechanism available. This is only partially true, however, as the restructuring of the European steel, textiles and shipbuilding industries in

³² The fact that the decisions in the cases of KBC, ING and Lloyds address the issue of capital adequacy (at least as regards measures taken by banks that may reduce the total amount of their own funds) would appear to indicate the need for close consultation on such technical matters with the Commission services responsible for the relevant regulatory and supervisory instruments (e.g. the Capital Requirements Directive and its proposed modification).

³³ It does not appear from the published Commission papers on these cases that many (or indeed any) competitors or other member states participated in the Commission’s procedures in individual cases such as KBC, ING and Lloyds.

the 1970s and 1980s demonstrates. It would be perfectly possible to combine ‘autonomous’ action by the Commission with cooperative measures adopted by member states (for example on the basis of EU measures adopted under Article 109 TFEU), together with an external dimension, if the necessary political will for such a coordinated approach existed. It was, after all, the ECOFIN Council in February 2008³⁴ that originally laid down the principles to be followed (inter alia by the Commission) in repairing the damage caused by the crisis, so as to ensure a level playing field within the EU and a more competitive financial services industry globally. At the same time, ECOFIN laid the groundwork for the regulatory and supervisory measures to be taken to prevent this situation arising in the future.

The Commission itself recently organised a high level conference on crisis management on 19 March 2010, which agreed on the need for:

- strong support for harmonising crisis management tools, based on clear threshold conditions and a common assessment of banks’ vulnerabilities;
- support for a coordination framework between national authorities, perhaps – in due course – to cover insolvency regimes for banking groups; and
- basing future resolution systems on the ‘polluter pays’ principle.

Many of the objectives of the new crisis management framework are identical to those in the state aid field. These include minimising overall costs and protecting public funds, avoiding competitive distortions and ensuring a level playing field in the internal market. The framework is to apply to individual institutions whether or not they are systemically important. The Commission’s paper recognises that financial support may be one solution in appropriate circumstances, that moral hazard should be avoided and that such financial support should comply with state aid rules.

Whilst it is appreciated that the Commission’s actions on state aid were and are essential to deal with the current threatened collapse of the banking system, and the proposed crisis management system is intended to prevent such a situation ever arising again, logic would appear to suggest a

³⁴ Confirmed by the European Councils on 20 March 2009 and 18-19 June 2009.

need for the EU (institutions and member states) to take an holistic view combining ‘both sides of the coin’.

In theory, assuming that all the Commission’s decisions on restructuring aid could be taken in 2010, it would be possible for an overview to be taken of the internal market for banking and related services that would emerge when considering the entirety of the Commission’s decisions. The Commission itself might prepare a paper for the European Council (via ECOFIN), in which it would draw appropriate conclusions from the restructuring ‘package’ seen as a whole.

There are of course immediate objections to such a far-reaching idea. First, the Commission might well maintain that – under the Treaty - its state aid decisions are subject to review only by the European Courts. The Commission traditionally maintains that, when it has decided that a state aid within the meaning of Article 107(1) TFEU exists, then the Commission has no discretion other than to take a decision that either holds that an aid is incompatible with the internal market and must be abolished or may be deemed compatible under certain conditions. It would be difficult for the Commission to deny, however, that there is no element of discretion or economic appreciation in its ‘designing’ the form and content of national restructuring measures (including ‘compensation’ measures to remedy distortions of competition). There is therefore no obvious reason why the restructuring process as a whole could not be reviewed and, if necessary, adjusted, provided this was done within a reasonable timeframe.

There is also the problem of judicial review. Most cases take a minimum of three to five years to be resolved, unless an accelerated procedure is used. It is not entirely clear that litigation under these conditions provides a solution for the litigants, shareholders or markets, certainly not in the short term. If we assume that the Commission’s decision will be annulled by the Court in a few years time, the Commission would be required to recommence its examination of the case. Experience shows that such a re-examination can add on months or years to this process.

There is no doubt that more comprehensive consultations embracing all the aspects of the current crisis (legal, regulatory, supervisory, macro-economic, monetary, fiscal, international etc.) pose political and practical problems, particularly in a European Union of 27 member states and with an institutional structure which is in any event complex, but exacerbated by the division between the eurozone and non-eurozone member states.

Of course, if (unlike the Netherlands government and ING) member states and banks are content to accept the individual Commission decisions in 'their' cases (possibly because the state aid procedure has been able to produce agreement between the Commission, member state and bank(s) concerned on the scope of restructuring measures), then the need for modifications or adaptations to be made ex post is less apparent. Nonetheless, given the scale of the restructuring exercise currently underway, and the intrinsic relationship between the European banking industry, there does at least seem to be a strong case in favour of a more 'joined up' approach than is currently being followed within the EU.

III. STATE AID IN A GLOBAL CONTEXT

The financial crisis has brought to the forefront two truths about the international banking system. First, large banks are international organisations, meaning that they conduct a substantial amount of their business outside their home country. Second, these banks are extremely interconnected due to extensive OTC securities and derivatives trading as well as through interbank money lending.

While banks are increasingly global in nature, legislation is still largely domestic – or at best regional in the case of the EU. The implications of this absence of global legislation are significant as state aid policy in one country could have distorting effects on competition in another. For example, if a bank has access to state aid from its home government, this could give this bank a competitive advantage also in host countries. Furthermore, there are incidences whereby foreign-owned banks have been excluded from state aid provided to domestic banks. An example is seen with countries that make state aid eligible only to banks having their corporate headquarters in the country.

At the global level, three fora exist for ‘regulating’ the financial services industry: the G20, international organisations as monitoring authorities, and, most importantly, the WTO.

The G20

As a result of the crisis, the G-20 has emerged as the forum to discuss international economic and financial sector governance, rapidly pushing the G-7 aside. The London and Pittsburgh G-20 meetings issued strong and detailed declarations of intent. The G-20 instituted a new structure for global coordination in financial regulation and supervision, and called for a coordination of exit strategies, but stops short of any direct references to state aid and possible competitive distortions from a global perspective.

Within the G-20 context, the Financial Stability Board (FSB) has played a significant role in advising on coordination of crisis management. In the “Principles for Cross-border Cooperation on Crisis Management” members have agreed that during a crisis, authorities will:

Strive to find internationally coordinated solutions that take account of the impact of the crisis on the financial systems and real economies of other countries, drawing on information, arrangements and plans developed ex-ante. These coordinated solutions will most likely be mainly driven by groups of authorities of the most directly involved countries.³⁵

Attempts at the G-20 to achieve this in practice were seen at the November 2009 G-20 finance ministers meeting where members agreed to exchange notes on their exit plans for bank state aid introduced since 2007, so as to avoid surprises and facilitate coordination where possible and needed.³⁶ At that meeting it was agreed by members that any removal of emergency measures requires a considerable amount of judgment and flexibility with respect to timing and sequencing, and that the withdrawal of support measures may also have lateral effects on other countries. Considering this, gains should be achieved from advance information exchange and from stronger forms of co-ordination where such side effects are potentially significant.³⁷

Specifically, it was agreed that four general principles should guide the exit strategies. First, the goal of any exit strategy should be to *enhance stability*. In practice, this means that policies should err on the side of caution and remain in place in the short term as a means to reassure the market, even if they go unused. Second, pricing and other conditions of support measures should support a *market-based exit*, meaning that the

³⁵ Financial Stability Board, “FSF Principles for Cross-border Cooperation on Crisis Management”, 2 April 2009 (http://www.financialstabilityboard.org/publications/r_0904c.pdf).

³⁶ Financial Stability Board, “Exit from extraordinary financial sector support measures”, Note for G20 Ministers and Governors meeting, 6-7 November 2009, p. 1 (http://www.financialstabilityboard.org/publications/r_091107b.pdf).

³⁷ Financial Stability Board, “Exit from extraordinary financial sector support measures”, Note for G20 Ministers and Governors meeting, 6-7 November 2009, pp. 1-2 (http://www.financialstabilityboard.org/publications/r_091107b.pdf).

incentives of market participants should lead them to draw less on support measures as markets normalise. In this case, as differing pricing among countries can have a clearly distorting effect, coordinating pricing strategies among countries is one area where cooperation is seen to be important. Third, members should take into account *cross border effects* when formulating and implementing exit strategies. Last, the timing of exits should be as early as possible, but reflect the need for *economic stability*, and announcements for exits must take into account impacts on market confidence at certain times.³⁸

In addition to the note, the FSB requested that the International Association of Deposit Insurers (IADI) and the International Monetary Fund (IMF) report on strategies to unwind temporary depositor protection in the wake of the crisis. The results showed that many of the enhanced deposit schemes differed in time and scope and in order to avoid distortions, cooperation was needed during exits.

The work done by the G-20 FSB represents a concerted effort to coordinate crisis management among members. It should be recognised, however, that the note only refers to exit strategies, and not to the state aid packages themselves. Because of this, it is not within the mandate of the FSB to ensure that individual state aid packages do not contradict free competition. In addition, the G-20 note does not cover emergency fiscal or monetary policies. As a lack of coordination in these areas could have distorting effects in practice, the FSB represents only one of the actors in the overall policy coordination.

International organisations

Several other international organisations play a role in monitoring and making proposals for international financial sector governance. A new initiative is Global Standard, which was launched by the Italian G8 presidency in 2009, to develop a set of common principles and standards for propriety, integrity and transparency in international business and finance. The following organisations are in the working group:

³⁸ For a more detailed summary see text of the note: Financial Stability Board, “Exit from extraordinary financial sector support measures”, Note for G20 Ministers and Governors meeting, 6-7 November 2009 (http://www.financialstabilityboard.org/publications/r_091107b.pdf).

International Labour Organisation (ILO), the International Monetary Fund (IMF), the World Bank, the World Trade Organisation (WTO) and the OECD (as the coordinator). The group has been vocal in calling on governments to resist protectionism, and improve international regulation of financial markets.

The Global Standard calls for convergence on a wide range of topics including corporate governance, market integrity, financial regulation and supervision, tax cooperation, and transparency of macroeconomic policy and data. The group has addressed many aspects of competition policy and the effects of current policies on public debt. As with many international organisations, compliance and enforcement is often an issue as implementation is left to individual states. Given its recent start, it is too early to make an assessment of this initiative.

The WTO

By far the most developed forum for multilateral liberalisation of trade in financial services is the WTO's General Agreement on Trade in Services (GATS). Pursuant to Article I:2, the GATS covers the following forms of trade in services: Cross-border supply, Consumption abroad; Commercial presence; and Movement of natural persons. With respect to state aid to the banking industry, the most important concern is the establishment of commercial presence whereby the service is provided within a country by a locally-established affiliate, a subsidiary, or by a representative office of a foreign-owned and foreign-controlled company. In the absence of a commercial presence (for example if an online bank were to offer services in a host country, but not maintain a physical presence in that country) governments are not required to adhere to the obligation to provide national treatment when they provide financial aid to banks. If this were the case, they would be required to provide aid extraterritorially.

Specifically, two articles within the GATS are relevant when considering situations where state aid may have distorting effects on competition. First, GATS Article XV (Subsidies) recognises that any subsidies offered might have "trade distortive effects". However, Article XV GATS does not impose obligations with regard to subsidies that are granted by WTO members in relation to *services* or *service suppliers*. It only indicates that members "shall enter into negotiations" to develop disciplines to avoid trade-distortive effects of subsidies. This is a matter dealt with in the Doha Negotiations, but negotiations have until now not

resulted in anything substantial. In the case that a member considers that it is adversely affected by a subsidy of another member, it may request consultations on such matters. According to the article, “such requests shall be accorded sympathetic consideration”.

Second, and at present more importantly, GATS Article XVII:1 (National Treatment) states that a

Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

This equal treatment may be achieved either by offering identical treatment, or formally different treatment that accords the same benefits and does not result in any distorting effects. It is important to stress that this obligation only applies to the extent the WTO member in question has made a national treatment commitment in the sector at stake (here: financial services) and has not inscribed a limitation to its commitment (e.g. for state aid).

It should be noted that the national treatment obligation only applies to measures that affect the competitive environment in the member state taking the measures. This is significant as government guarantees offered to a bank in one country could heighten the perceived stability of that bank abroad, and thus give it a competitive advantage over other banks operating in its foreign markets. Under the current GATS framework, there is no recourse in this situation.³⁹

Preliminary conclusions from GATS XVII:1 are that members must accord national treatment to all financial service providers with a commercial presence in their country to the extent that any treatment could have anticompetitive effects within that country. Thus, one could assume that banks receiving state aid by a member state of the EU must also extend that aid to foreign (i.e. non-EU) banks with a commercial presence in the member state. Currently, this is not the case in certain member states of the

³⁹ See Bart De Meester (2010), “The Global Financial Crisis and Government Support for Banks: What Role for the GATS?”, *Journal of International Economic Law*, Vol. 13, No. 1.

EU as state aid is often contingent on the organisation being incorporated in the country, and of systemic importance.

The National Treatment provision under GATS is complicated by the WTO's "Understanding on Commitments in Financial Services". The Understanding applies when a member has indicated in its schedules of commitments that it makes commitments on the basis of the Understanding. The Understanding contains a number of 'model commitments', providing some harmonised commitments for liberalisation of trade in financial services that go further than what members might otherwise have done. In Part C of the Understanding (National Treatment) it is stated that:

Under terms and conditions that accord national treatment, each Member shall grant to financial service suppliers of any other Member established in its territory access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the *normal course of ordinary business*. This paragraph is not intended to confer access to the Member's lender of last resort facilities.

The paragraph in the Understanding clearly excludes lender of last resort facilities from the scope of the obligation to provide National Treatment. Government assistance that are not lender of last resort facilities may be considered "official funding and refinancing facilities", to which the national treatment obligation set out in this paragraph would normally apply. The financial crisis can hardly be considered a "normal course of ordinary business" circumstance. Still, one could argue that the national treatment obligation in Article XVII GATS would continue to apply for other types of 'emergency aid', such as the support schemes discussed above. Hence, WTO Members must not limit the aid to domestic banks and exclude foreign-owned banks with a commercial presence from this benefit. This is of course subject to the precondition that the member in question has made a National Treatment commitment without relevant limitation.

To date there have been no cases brought to the WTO regarding the anti-competitive effects of state aid to banks. This could be a function of many things such as the lack of clarity of the law, or the ubiquity with which states have provided aid to the financial sector. One major legal reason is perhaps the existence of an exception for measures that violate an obligation in the GATS but are "taken for prudential reasons", as provided for in Paragraph 2 (a) of the GATS Annex on Financial Services. As an

example of such measures, the paragraph mentions measures taken “to ensure the integrity and stability of the financial system”. This provision may not be used to avoid a country’s obligations and commitments under the GATS agreement on national treatment or market access.⁴⁰ Considering this, one may assume that countries feel that current state aid does fall within the scope of the prudential carve-out, and that it is not intended to be trade restrictive.

Whatever the reason, the lack of use of the WTO in regulating anti-competitive practices related to state aid suggests that many improvements could be made in the way competition in the market for financial services is regulated at the global level. The financial crisis confirmed the impression of the minimal relevance of the current multilateral framework regulating trade in services. The post-crisis period therefore offers a unique opportunity to clarify the scope of GATS law as related to financial services to establish with greater precision the remit of the prudential carve-out. If not, the construct will remain more of a theoretical nature.⁴¹

⁴⁰ Sydney J. Key (2003), *The Doha Round and Financial Services Negotiations*, AEI Press, American Enterprise Institute, Washington, D.C., p. 25.

⁴¹ Pierre Sauvé and Panagiotis Delimatsis (2010), *Financial Services Trade after the Crisis: Policy and Legal Conjunctures*, TILEC Discussion Paper, Tilburg Law and Economics Center, University of Tilberg, NL, August, p. 18.

OUTLOOK

The EU gave a strong impression of being unprepared when the financial crisis hit. It had been calling for a single market for financial services for some 20 years, but when the crisis hit, no contingency plans were in place for organising bank rescues in an orderly way at the European level. In the meantime, efforts are being taken on several fronts to draw lessons from the crisis. Work is well advanced to create a new EU supervisory architecture: a European Systemic Risk Board and a Banking Authority are in the making, the latter of which will have the powers to take individual decisions in emergency situations. The European Commission has also embarked upon a far-ranging discussion on bank crisis management and resolution procedures. In this regard, specific proposals have been made by third parties for the creation of new entities designed to intervene in crisis situations and to bail out banks, namely a European Deposit Guarantee Fund (Carmassi et al., 2010), a Financial Sector Stabilisation Fund (Speyer, 2010) and a European Resolution Authority (Strauss-Kahn and IMF, 2010).

What seems to have been overlooked in all these proposals for a new resolution framework is the integration of the EU's state aid policy rules. Should the financial sector be exempted from the application of EU state aid policy, as some have argued? Will an eventual European framework for bank resolution not create an even larger moral hazard? This Task Force report concludes that any proposed resolution authority must integrate, clearly specify and reflect the EU's state aid policy objectives of proportionality, necessity and focus.

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ANNEX 1. FORM OF INTERVENTIONS BY EU STATES IN SUPPORT OF FINANCIAL INSTITUTIONS, SEPT. 2007- OCT. 2010

| Member state | Guarantee schemes | Recapitalisation schemes | Schemes combining several measures | Other measures | Affected financial institutions * |
|--------------|-------------------|--------------------------|------------------------------------|----------------|-----------------------------------|
| Austria | | | x | | 3 |
| Belgium | | | | | 5 |
| Bulgaria | | | | | |
| Cyprus | x | | | | |
| Czech Rep. | | | | | |
| Denmark | x | x | | | 2 |
| Estonia | | | | | |
| Finland | x | x | | | 1 |
| France | x | x | | | 1 |
| Germany | | | x | | 13 |
| Greece | | | x | | |
| Hungary | | | x | | |
| Ireland | x | x | | | 4 |
| Italy | x | x | | | |
| Latvia | x | | | | 2 |
| Lithuania | | | x | | |
| Luxembourg | | | | | 1 |
| Malta | | | | | |
| Netherlands | x | | | | 4 |
| Poland | x | x | | | |
| Portugal | x | x | | | 1 |
| Romania | | | | | |
| Slovakia | x | x | | | |
| Slovenia | x | x | | | |
| Spain | x | x | | x | 1 |
| Sweden | x | x | | | 1 |
| UK | x | | x | | 5 |
| EU total | | | | | 44 |

* This number counts cases during the financial crisis concerning one and the same bank only once.

Source: Compiled from European Commission, DG Comp, updated until August 2010.

ANNEX 2. TIMELINE OF IMPLEMENTATION OF GUARANTEE AND RECAPITALISATION MEASURES

Table 1. Guarantee schemes approved by the Commission since October 2008

| | 2008 | | | | | | | | | | | | 2009 | | | | | | | | | | | | 2010 | | | | | | | | | | | | | |
|----------------|------|---|---|---|---|---|---|---|---|----|----|----|------|---|---|---|---|---|---|---|---|----|----|----|------|---|---|---|---|---|---|---|---|----|----|----|--|--|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | | |
| France | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Italy | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| United Kingdom | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Sweden | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Cyprus | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Ireland | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Germany | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Netherlands | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Portugal | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Denmark | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Finland | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Greece | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Austria | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Slovenia | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Latvia | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Spain | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Hungary | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Poland | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Slovakia | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Lithuania | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

Table 2. Recapitalisation schemes approved by the Commission since October 2008

| | 2008 | | | | | | | | | | | | 2009 | | | | | | | | | | | | 2010 | | | | | | | | | | | | | |
|----------------|------|---|---|---|---|---|---|---|---|----|----|----|------|---|---|---|---|---|---|---|---|----|----|----|------|---|---|---|---|---|---|---|---|----|----|----|--|--|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | | |
| France | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Italy | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Denmark | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| United Kingdom | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Szwden | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Germany | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Greece | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Austria | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Hungary | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Portugal | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Slovakia | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Poland | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Spain | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Finland | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Lithuania | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

Source: EU Commission, DG COMP.

ANNEX 3. SUMMARY OF EUROPEAN COMMISSION POSITIONS ON STATE AID IN THE FINANCIAL SECTOR

The “Banking Communication” of 13 October 2008

The application of State aid rules in relation to financial institutions in the context of the current financial crisis, 2008/C270/02 of 25 October 2008

The Commission stresses in this document that any support measure taken should be exceptional, and that the situation in the financial sector should be reviewed every six months. These measures could otherwise “generate harmful moral hazard”.⁴² The European Commission specified several conditions that must be met in national support schemes:

- Non-discriminatory access, eligibility for support should not be based on nationality;
- State commitments must be limited in time and scope, while excluding unjustified benefits for shareholders;
- Adequate remuneration of the state financial support (in guarantee or debt schemes), recapitalisation must be limited to the minimum necessary and followed by a restructuring plan;
- Private sector contribution;
- Behavioural rules for beneficiaries that prevent an abuse of state support, such as expansion and aggressive market strategies on the back of a state guarantee;
- State aid should be followed by structural adjustment measures; and
- Winding-up procedures should be open and take place on market terms.

The Communication adds that observance of these principles, including in individual aid measures, is the responsibility of the member states, subject to monitoring by the Commission.

⁴² European Commission (2008b, p. 10).

The “Recapitalisation Communication” of 5 December 2008

The recapitalisation of financial institutions in the current financial crisis: limitations of aid to the minimum necessary and safeguards against undue distortions of competition, C(2008)8259 of 5 December 2008

The difficulties national state aid schemes pose to free competition led the European Commission to publish a further Communication in December 2008 on the principles governing state recapitalisation of financial institutions. State capital injections need to be remunerated close to market prices to avoid distortions of competition at EU level, but they need also to take into account the different circumstances of the banks and financial markets in question. Lack of differentiation may also weaken the overall competitiveness of European banks. The Commission Communication therefore proposes some pricing mechanisms for state recapitalisations and a price corridor determined by:

- i) the required rate of return on subordinated debt representing a *lower bound* (being 7%) and
- ii) the required rate of return on ordinary shares representing an *upper bound* (being 9.3%).

The Communication complements this guidance to include conditions other than remuneration rates and deals with the terms under which distressed, less-performing banks may have access to public capital.

The “Impaired Assets Communication” of 25 February 2009

The treatment of impaired assets in the Community banking sector, 2009/C 72/0 of 25.02.2009

This Communication gives guidance on how member states can create state aid schemes for impaired assets in conformity with EU rules and sets the rules these schemes must fulfil to gain state aid approval. The Communication covers both the purchase of impaired assets by the state (bad bank schemes) as well as insurance solutions, guarantees and the nationalisation of banks. The exact form of the relief measures remains the responsibility of each member state, but they will be assessed by the EU from a state aid perspective. The Commission discusses the following principles:

- development of eligible categories of assets (“baskets”)

- coordinated approach to valuation and pricing of assets eligible for relief; the valuation of impaired assets should be based on a uniform methodology established at Community level, and validated by the European Commission;
- further definition of the state aid rules and relief award procedure; full transparency and disclosure of impairments, with adequate burden-sharing of the costs related to impaired asset between the shareholders, the creditors and the State, and adequate remuneration for the State;
- time limitation of the relief programme and incentives to participate; imposition of behavioural constraints.

The “restructuring communication” of 19 August 2009

The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under state aid rules, 2009/C 195/04 of 19.08.2009

This communication deals with the restructuring plan member states need to submit for banks that benefit from state aid. The plan should demonstrate how the bank will restore long-term viability with state support, including a comparison with alternative options, such as break-up or merger with another entity. Restructuring plans should not last more than five years. State support should be limited to the minimum necessary and be mirrored by equity holders. State aid should not be used for the acquisition of competing business, a condition that applies for at least three years and may continue until the end of the restructuring period. The Communication applies until end-2010.

ANNEX 4. SUMMARY OF BAD BANK SCHEMES

1. The Irish Impaired Assets Scheme⁴³

On 10 September 2009, the Irish government published the National Asset Management Agency (NAMA) Bill. NAMA is a statutory body corporate, with its proper board of directors appointed by the minister. The agency has extensive powers to acquire and manage debt facilities and the underlying property and property-related assets upon which such facilities are secured. Accordingly, NAMA's purposes, as outlined by the government, are the following:

- i) the acquisition by that Agency of certain assets from certain persons to be designated by the Minister for Finance;
- ii) effecting the expeditious and efficient transfer of those assets to that Agency;
- iii) the holding, managing and realizing of those assets by that Agency (including the collection of interest and capital due, the taking or taking over of collateral where necessary and the provision of funds where appropriate);
- iv) the taking by that Agency of all steps necessary or expedient to protect, enhance and better realize the value of assets transferred to it;
- v) the performance by that Agency of such other functions, related to the management or realization of those assets, as provided in this Act or as directed by the Minister;
- vi) the facilitation of restructuring of credit institutions of systemic importance to the economy, and to provide for the valuation of the assets concerned and the review of any such valuation, to give the National Asset Management Agency certain powers and other functions in respect of land or an interest in land acquired by that Agency, including powers relating to the development of land, to provide for the issuing of debt securities by the Minister for Finance

⁴³ See Boughdene, Yassine et al. (2010) for a more comprehensive overview and assessment of bad bank schemes in the EU.

and by that Agency in the performance of its functions under this Act.⁴⁴

Under the scheme, banks can apply to participate in NAMA within 28 days of the commencement of the legislation, a date to be determined by the Finance Ministry. The Ministry will approve banks based on their systemic importance to the financial system as well as the extent to which they are *eligible for support by a foreign government or parent company*.

The valuation of assets to be purchased by NAMA is perhaps the bill's most controversial aspect. According to the bill bank assets will be priced at their *long-term economic value*. Part 5, Article 70 of the Bill, "Valuation Methodology" contends that long term economic value is defined as the following:

- i) a reference to the long-term economic value of a *property* is a reference to the value, as determined by NAMA in accordance with this Part, that it can reasonably be expected to attain in a stable financial system when the crisis conditions prevailing at the passing of this Act are ameliorated and in which a future price or yield of the property is consistent with reasonable expectations having regard to the long-term historical average, and
- ii) a reference to the long-term economic value of a *bank asset* is a reference to the value, as determined by NAMA in accordance with this Part, that it can reasonably be expected to attain in a stable financial system when the crisis conditions prevailing at the passing of this Act are ameliorated⁴⁵

The bill states that NAMA will consider all of the following when determining the long-term economic value of assets it purchases:

- the market value of the property;
- the market value of the bank asset;
- the long-term economic value of the property;

⁴⁴ **National Asset Management Agency Bill, 2009:**
<http://www.oireachtas.ie/viewdoc.asp?DocID=12724>

⁴⁵ **National Asset Management Agency Bill, 2009:**
<http://www.oireachtas.ie/viewdoc.asp?DocID=12724>

- the long-term economic value already determined by NAMA, in accordance with the valuation methodology, of any other similar property or bank asset;
- credit-worthiness of debtors
- performance history of debtors

Compliance with Commission state aid rules

It is likely that using long-term valuation will result in NAMA valuing and purchasing assets above their present market value. This is highlighted by the ministry stating it will exercise wide discretion and consider all factors when determining the value of assets it purchases. If assets purchased by NAMA are valued at prices above current market rates, this may not necessarily contradict Commission state aid policy as long as the conditions in the Commission Communication, noted above, are met, namely, all purchases safeguard financial stability and underpin bank lending; purchases do not affect budget sustainability or debt requirements; purchases follow a Community approach. If purchases go beyond these principles, this will likely be considered illegal state aid.

Another cause for concern may be the way NAMA applies its ability to consider the access foreign banks operating in Ireland have to state aid from their home country or liquidity from a parent company. If this discretion is done within the context of the Community approach, and thus seeks to ensure burden sharing and cooperation with other national authorities, actions will comply with EU state aid legislation. If, however, NAMA is seen to discriminate against foreign banks operating in Ireland by not providing asset relief (that would otherwise improve financial stability and enhance lending) this could go against EU state aid law that requires governments to act in a non-discriminatory way when granting state aid.

Commission approval

The asset relief scheme was approved on 26 February 2010. The mechanism is said to meet the Commission's Communication on the treatment of impaired assets. Specifically, the scheme was non-discriminatory as it is open to all systemically important credit institutions established in Ireland, including subsidiaries of foreign banks. The scheme is also limited in time as it had a 60-day application window that expired on 19 February 2010.

Five institutions participate: Anglo Irish Bank, Allied Irish Bank, Bank of Ireland, Irish Nationwide Building Society and Educational Building Society.

NAMA is said to meet Commission requirements regarding disclosure, transparency, and the alignment of banks' incentives with public policy objectives. The scheme includes an adequate burden-sharing mechanism through the payment of a transfer price that is no greater than the assets' long-term economic value, and the inclusion of an adequate remuneration for the state in the rate used to discount the assets' long-term economic cash flows.

The Irish authorities anticipated that NAMA would purchase land and development loans as well as associated commercial loans with a nominal value of approximately €80 billion for an estimated purchase price of €54 billion.

The approval is only for the scheme. The Commission will assess the compatibility (and, in particular, the actual transfer price) of the transferred assets when they are separately notified by the Irish authorities.⁴⁶ These individual reviews will include a claw-back mechanism in case of excess payments.⁴⁷

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<http://www.oireachtas.ie/viewdoc.asp?DocID=12724>
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- DG Competition Website, 26.2.10:
<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/198&format=HTML&aged=0&language=EN&guiLanguage=en>

⁴⁶ On 3 August 2010, the European Commission authorised the transfer of the first tranche of assets to the NAMA.

⁴⁷ All information can be found on DG Competition Website.

2. German Impaired Asset Scheme

On 23 July 2009, the German “Bad Bank Act” (Gesetz zur Fortentwicklung der Finanzmarktstabilisierung) came into force. Specifically, the act sets out three distinct models for asset relief: a special purpose vehicle (SPV), a federal law resolution agencies model, and a state law resolution agencies model.

The special purpose vehicle

The SPV allows banks to remove risk positions, in particular “structured securities”, off their balance sheets. The term “structured securities” is defined in vague terms in the Act. According to the explanatory memorandum it includes “bonds created in the course of complex securitization transactions or securities issued in the course of securitization transactions of a portfolio of various types of assets”. Examples of structured securities include asset-backed securities, collateralised debt and loan obligations, and mortgage-backed securities (residential and commercial). Only ‘structured securities’ purchased on or before 31 December 2008 are eligible for removal.

Institutions seeking asset relief are required to fulfil certain eligibility requirements. Contrary to other financial stabilisation measures taken by the German government, eligibility for asset relief via the SPV is more limited. Only credit institutions or financial holding companies with a domestic seat or a domestic or foreign subsidiary of such a company are eligible. This means that insurance companies, pension funds and investment companies are not eligible transferring entities.⁴⁸

There are also limitations on transfer value. According to the act, structured securities transferred to the SPV must be ‘sold’ at whichever is the highest value:

- 1) 90% of the book value as of June 30 2008
- 2) 90% of the book value as of March 31 2009
- 3) The actual economic value

⁴⁸ Freshfields Bruckhaus Deringer Briefing “German Bad Bank Act in Force”, (August 2009), p. 2.

It should be noted that the 10% reduction in asset price reflects EU Commission guidelines, but that this reduction will only be made if the transferring entity can maintain a core capital ratio of 7%.⁴⁹

In exchange for the toxic assets, banks receive debt securities from the SPV. These guarantees are backed by the government, thus removing valuation risks. As the debt securities are backed by the Federal government they can be used to raise liquidity. Any losses incurred on assets are only indirectly born by the transferring entity and are limited to any dividends that may be paid out of the annual profit of the entity.

The federal law resolution agencies model

Under the federal resolution model the role of the bad bank is assumed by agencies created within the Federal Market Stabilization Authority (FMSA). As such, any risks are more closely connected to the Federal government. In addition, risks may be greater as the scope and volume of assets that can be transferred is larger than under the SPV. Transferring entities may sell 'structured securities' as well as 'risk positions'. Risk positions comprise receivables, securities (including government bonds), derivative financial instruments, and rights and obligations from loan commitments or guarantees. This expanded list is meant to allow banks to greatly reduce their balance sheet and streamline operations (which may be used in the event that the EU imposes restructuring requirements).⁵⁰

In addition, transferring companies may include SPVs. To compensate for the higher risk, transferring entities must directly compensate for any losses incurred on assets bought by the agency (i.e. the principle of owner responsibility). The German government expects that the value of assets to be transferred to the federal law resolution agencies will be roughly three to four times larger than to the SPV.⁵¹

⁴⁹ Bundesministerium der Finanzen, „Gesetz zur Fortentwicklung der Finanzmarktstabilisierung“ 22.7.09:
http://www.bundesfinanzministerium.de/nm_67366/DE/BMF__Startseite/node.html?__nnn=true

⁵⁰ Op. cit., *Freshfields Bruckhaus Deringer Briefing*.

⁵¹ *Ibid.*, *Freshfields Bruckhaus Deringer Briefing*.

As with the SPV model, only assets purchased on or before 31 December 2008 are eligible for transfer to an agency. Agencies are created by the FMSA upon request from a transferring company, but are legally, economically, and organisationally independent from the FMSA. In being independent, agencies must use accounting rules under the German Commercial Code.⁵²

Last, there are differences in the way SPV and agencies may obtain transferred assets. First, assets may be moved to Agencies through individual transfers. Second, assets may be moved through a re-organisation (spin-off or hive-down). Last, economic transfer is permitted whereby agencies can offer guarantees without obtaining any assets through a legal transfer.⁵³

State law resolution agencies model

The state law resolution agency works similarly to the federal law agency. The basic principle is to provide banks in each state asset relief opportunities at the state level similar to those offered at the federal level. The state agency is supervised by the German Federal Financial Supervisory Authority as well as by the authorities of the federal states. Legally, there is no institutional connection between the FMSA and the state agencies.⁵⁴

Commission approval

The asset relief scheme was approved on 31 July 2009. The mechanism was said to meet the Commission's Guidance Communication on the treatment of impaired assets. Specifically, the scheme provides *ex ante* transparency and disclosure of impairments, valuation of the assets based on their real economic value, a burden-sharing of the costs related to the

⁵² Bundesministerium der Finanzen, „Gesetz zur Fortentwicklung der Finanzmarktstabilisierung“ 22.7.09: http://www.bundesfinanzministerium.de/nm_67366/DE/BMF__Startseite/node.html?__nnn=true

⁵³ Ibid. „Gesetz zur Fortentwicklung der Finanzmarktstabilisierung“, and supported by “German Bad Bank Act in Force”, *Freshfields Bruckhaus Deringer Briefing* (August 2009), p. 5.

⁵⁴ Ibid., „Gesetz zur Fortentwicklung der Finanzmarktstabilisierung“.

operation and adequate remuneration. In addition, the scheme is limited in time and scope as the enrolment period for asset relief is limited to six months.

In terms of transparency, the real economic value of the assets to be transferred is established by the financial institution prior to the asset relief measure. It is then assessed by independent experts and confirmed by the competent supervisory authority. Furthermore, the real economic value has to be published in the annual report of the beneficiary.

Burden-sharing is ensured *ex post* through the beneficiary's obligation to pay the difference between the transfer value and the fundamental value. This payment is made in annual instalments. The payment requirement is in line with the EU requirements for the remuneration of recapitalisations.⁵⁵

⁵⁵ See DG Competition Website for all compliance information, 31.7.09: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1216&format=HTML&aged=0&language=EN&guiLanguage=en>

ANNEX 5. STATE AID BY COUNTRY (UP TO END OCTOBER 2010)

| Country | €bn capital injections/ guarantees | Tools/Legislation | Eligible Institutions | Conditionality | Date initially Approved by Commission | Additional actions by the EU Commission – Action on specific cases |
|----------------|------------------------------------|---|--|--|---------------------------------------|--|
| Austria | C.I. 15 Guar. 75 | Government to guarantee €75 billion in loans, inject up to €15 billion in capital, and allocate up to €10 billion to guarantee public savings | Credit and insurance institutions | Dividend restriction and a remuneration corridor | 10-Dec-08 | <p>25 June 2010 – Extension of guarantee scheme</p> <p>20 June 2010 – Approval of restructuring of BAWAG bank</p> <p>23 Dec 2009 – Authorisation of Hypo Group Alpe Adria (HGAA) rescue</p> <p>22 Dec 2009 – Provisional authorisation of €550 million capital injection and a €400 million guarantee for BAWAG bank</p> <p>17 December 2009 – Extension of guarantee scheme</p> <p>30 June 2009 – Extension of guarantee scheme</p> <p>17 June 2009 – €100 million recapitalisation measure for Hypo Tirol</p> |
| Belgium | C.I. n/a Guar. n/a | Guarantee begins 9 October 2008 and finishes 31 October 2009; Guarantees must be applied for between 9 October 2008 and 31 October 2009 | Any institution that is facing liquidity or insolvency problems that could have implications for the Belgian economy | Firms must promise to use government aid to institute measures to improve the financial situation of their firm; the Minister of Finance determines the conditions of the guarantee, including issues of | 20-Nov-08 | <p>20 May 2010 – Approval of restructuring of insurance company Ethias</p> <p>26 February 2010 – Approval of restructuring plan for Dexia</p> <p>18 November 2009 – Approval of restructuring package for KBC foresees structural and financial restructuring through the divestment, run-down and listing of various businesses</p> <p>30 Oct 2009 – Authorisation of temporary prolongation of the guarantee jointly granted by Belgium, France and Luxembourg on the debt of</p> |

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|----------------|-----------------------|---|--|---|-----------|--|
| | | | | remuneration | | <p>Dexia.</p> <p>30 June 2009 - €3.5 billion recapitalisation and temporary clearance for impaired asset relief, with final approval dependent on the result of an in-depth investigation for KBC Group</p> <p>12 May 2009 – Commission approves additional aid from Belgium and Luxembourg for Fortis. The additional aid for Fortis was necessary to allow the sale of the bank to BNP Paribas to proceed</p> <p>13 Mar 2009 – Commission to investigate if state aid to Dexia will be accompanied by “realistic projects” to address the bank’s problems</p> <p>12 Feb 2009 – Approval of €1.5 capital injection for insurance and banking group Ethias</p> <p>18 Dec 2008 – Approval of €3.5 billion recap for KBC Group</p> <p>3 Dec 2008 - Commission clears state aid to rescue and restructure Fortis Bank and Fortis Bank Luxembourg</p> <p>20 Nov 2008 – Approval of guarantee of short and medium term wholesale funding for Fortis in joint aid from BE, LU, FR</p> <p>20 Nov 2008 – Approval of state guarantee for Dexia from BE, LU, FR</p> |
| Denmark | C.I. n/a Guar. n/a | Guarantee scheme; bank wind-up scheme | All banks in Denmark that have a banking license and participate in the Sector Fund | Limited to fundamentally sound financial institutions; banks pay premium to remunerate debt guarantee; insolvent banks to be wound | 10-Oct-08 | <p>25 October 2010 – Approval of measures to liquidate Fionia Bank</p> <p>30 September 2010 – Bad bank scheme authorised</p> <p>30 June 2010 – Extension of guarantee scheme</p> <p>17 December 2009 – Extension of guarantee scheme (but not of recap. scheme)</p> <p>17 August 2009 – Extension of guarantee and</p> |

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|----------------|----------------------|---|---|--|-----------|---|
| | | | | up using private funds when possible | | <p>recap. scheme</p> <p>20 May 2009 – Approval of credit facility of up to €685 million and a €134 million capital injection for Fionia Bank</p> <p>3 Feb 2009 - €13.5 billion recap scheme; amendments to existing guarantee scheme to allow integration of individual guarantees on new loans for up to three years</p> <p>5 Nov 2008 – Approval of liquidation aid from DNB and DPB for Roskilde Bank. Package includes €1.3 billion loan takeover and €670 million deposits takeover plus sales of parts of the bank</p> |
| Finland | C.I. 4 Guar. 50 | Guarantee to cover, against remuneration, the issuance of new short and medium term non-subordinated debt between 90 days and three years. Five year maturity for mortgage-backed bonds only. | All solvent Finnish deposit and mortgage banks, including Finnish subsidiaries of foreign banks | Restrictions on beneficiaries' balance sheet growth with regard to national and EU averages, limitations on expansion and marketing and strict conditions for staff remuneration or bonus payments | 14-Nov-08 | <p>17 Dec 2009 – Extension of guarantee scheme</p> <p>30 Apr 2009 – Prolongation/modification of Scheme. Guarantees may be issued until 31 Dec 2009; guarantee now covers instruments of up to a 5 yr maturity</p> <p>21 Jan 2009 - Nordea Bank Finland plc, OP-Pohjola Group Central Cooperative and Sampo Bank plc, and a special purpose vehicle took over the credit claims and other assets of Kaupthing Bank h.f. and settled all the deposit claims in Finland. The Finnish State provided a guarantee to the participants, to cover potential economic losses.</p> |
| France | C.I. 40 Guar. 360 | €40 billion capital injection into France's banks; Bank Debt guarantee of €360 billion | All French financial institutions | Cap on remunerations; banks will have to provide monthly reports on capital | 31-Oct-08 | <p>12 May 2009 - Extension of the refinancing scheme for credit institutions in France</p> <p>8 May 2009 – Approval of 2.45 billion capital injection into the institution to be created by the merger between the Caisse d'Épargne and Banque</p> |

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| | | | | use. Firms will also have to sign a 'code of ethics' | | <p>Populaire groups</p> <p>24 Mar 2009 – Scheme amendment. French scheme to encourage beneficiary banks to buy back preferred shares as early as possible by making the payback amount increase over time</p> <p>8 Dec 2008 – Approval of €21 billion French capital injection scheme</p> |
| Germany | C.I. 80 Guar. 400 | €400 billion in loan guarantees; can give further €80 billion in loans; €20 billion to cover potential losses from loans | Credit institutions, financial service providers, insurance companies and pension funds, operators of securities and commodities exchanges | Restrictions on remuneration for upper management; capital requirements; distribution of dividends; reporting requirements | 27-Oct-08 | <p>22 Dec 2009 - Commission temporarily approves urgent rescue aid for WestLB; opens in-depth investigation into bad bank. The bad bank will take over €85.1 billion in toxic assets. WestLB is receiving capital of €3 billion from Germany (SoFFin)</p> <p>21 Dec 2009 – Commission temporarily approves two state guarantees of €8 billion and €10 billion respectively for German bank Hypo Real Estate</p> <p>17 Dec 2009 –Prolongation of guarantee scheme</p> <p>15 Dec 2009 – Approval of Landesbank Baden Württemberg restructuring plan and impaired assets relief measure</p> <p>23 Oct 2009 - Commission opens in-depth investigation into aid package for German HSH Nordbank AG</p> <p>7 Oct 2009 - temporary increase of the guarantee for a portfolio of securities of German Landesbank WestLB.</p> <p>17 Aug 2009 – Approval of guarantees amounting up to €7 billion to the German bank IKB</p> <p>31 July 2009 - Commission approves German asset relief scheme</p> <p>30 June 2009 – Approval of temporary clearance to a recapitalisation and an asset relief measure</p> |

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| | | | | | <p>provided to Landesbank Baden-Württemberg</p> <p>22 June 2009 – Prolongation of guarantee scheme</p> <p>12 May 2009 - Commission opens in-depth investigation into aid package for German Landesbank BayernLB and its Austrian subsidiary Hypo Group Alpe Adria</p> <p>12 May 2009 –€5 billion risk shield for German bank WestLB</p> <p>7 May 2009 - €10 billion recap to Commerzbank (the bank received €8 billion in Dec 2008)</p> <p>7 May 2009 - In-depth investigation into aid package for German bank Hypo Real Estate</p> <p>22 Jan 2009 - €6.7 billion guarantee for SdB (for bond refinancing)</p> <p>23 Dec 2008 – Approval of guarantee package for NordLB and IKB</p> <p>18 Dec 2008 – Approval of capital injection and a risk shield for BayernLB</p> <p>12 Dec 2008 – Amendments to remuneration of recapitalisation measures (price for the state participation increases in proportion to its duration to encourage quick payback by users)</p> <p>21 Oct 2008 – Approval of €9 billion restructuring package for IKB. Two risk shields, capital injections and liquidity facilities</p> <p>2 Oct 2008 - Approval of loan guarantees totalling €35 billion for Hypo Real Estate Holding AG</p> |
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| Greece | C.I. 5 Guar. 15 | State to buy non-core tier 1 preference shares; guarantee scheme for debt between 3 months and 3 years; securities scheme, government bonds lent against bank collateral | All financially sound credit institutions licensed in Greece | Beneficiaries to pay a market-oriented remuneration | 19-Nov-08 | 30 June 2010 – Guarantee Scheme extended 25 January 2010 – Guarantee Scheme extended 18 September 2009 – Guarantee Scheme extended 19 Nov 2008 – Approval of plan to provide financial institutions new capital and securities which can be converted into liquidity with the ECB; and guarantees on short and medium term newly issued debt |
| Hungary | C.I. 2 Guar. 2 | Provide eligible credit institutions with new capital and guarantees on short and medium term newly issued debt | Open to all credit institutions of systemic importance on the Hungarian banking market | Beneficiaries to pay a market-oriented remuneration; measures target only fundamentally sound financial institutions | 12-Feb-09 | 14 Jan 2010 – Approval of Hungarian liquidity support scheme 17 Dec 2009 – Extension of recap. scheme 3 Sept 2009 – Extension of guarantee and recap. scheme 11 Mar 2009 – Approval of government grants in the form of guarantees for investment and working capital credit |
| Ireland | Guar. n/a | Covers all existing and new facilities issued from 29 September 2008 to 28 September 2010 | Banks with a systemic relevance for the Irish economy | Firm will be subject to specific terms and conditions so that the taxpayers' interest can be protected | 13-Oct-08 | 21 September 2010 – Guarantee Scheme of Irish financial institutions prolonged 10 August 2010 – Commission temporarily clears support for Anglo-Irish Bank 2 June 2010 – Recapitalisation of EBS (building society) 26 Feb 2010 - Commission approves Irish impaired asset relief scheme NAMA 20 Nov 2009 - Commission approves revised Irish guarantee scheme, providing guarantees on deposits and debt to eligible banks active on the Irish market. Limits on time and scope 26 June 2009 – emergency recapitalisation worth |

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| | | | | | | <p>€4 billion for Anglo Irish Bank</p> <p>12 May 2009 - recapitalisation worth €3.5 billion Allied Irish Bank</p> <p>26 Mar 2009 – €3.5 billion recapitalisation of Bank of Ireland</p> <p>17 Feb 2009 – Nationalisation of Anglo-Irish Bank</p> <p>14 Jan 2009 - €1.5 billion recap of Anglo-Irish Bank</p> |
| Italy | C.I. n/a Guar. n/a | Guarantee on new liabilities between 3 months and 5 years; 6 month renewable swap scheme between matching bank debt certificates and Treasury bills (40 billion cap); state guarantee for third parties borrowing from banks | Solvent banks authorised in Italy, including the subsidiaries of foreign groups | The total amount of guarantees issued with a maturity of more than three years will not exceed 25% of the total amount covered. Italy will monitor that the total amount to be received by a bank does not exceed certain pre-defined thresholds | 14-Nov-08 | <p>16 June 2009 - Extension of the guarantee scheme for banks</p> <p>20 Feb 2009 –Approval of amendment to recap. scheme with an alternative remuneration option (higher initial coupon and a higher annual coupon level) in exchange of a lower reimbursement price</p> <p>23 Dec 2008 – Commission approves recap scheme for Italian banks worth €15-€20 billion (subscribe subordinated debt instruments)</p> |
| Latvia | C.I. n/a Guar. n/a | Guarantee scheme covering all liabilities with the exception of inter-bank deposits, subordinated liabilities and collateralised liabilities such as covered bonds | Open to all solvent Latvian banks, including Latvian subsidiaries of foreign banks | Subject to behavioural commitments to avoid an abusive use of the state support. These include limitations on marketing and conditions for staff remuneration or bonus payments | 22-Dec-08 | <p>15 September 2010 – Commission clears restructuring of Parex Bank</p> <p>25 June 2010 – Extension of guarantee scheme</p> <p>17 Dec 2009 – Extension of guarantee scheme</p> <p>19 Nov 2009 - Commission approves €103 million capital injections for 'Mortgage and Land Bank of Latvia'</p> <p>27 July 2009 - In-depth investigation into state support measures for the Latvian JSC Parex Banka.</p> <p>11 May 2009 – Government to acquire newly issued ordinary shares and subordinated term</p> |

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| | | | | | | debt. 25 Nov 2008 – Approval of state guarantee covering certain existing and new loans for JSC Parex Banka 10 Nov 2008 – Government of Latvia Nationalizes Parex Banka |
| Lithuan. | C.I. n/a Guar. n/a | Guarantee, recapitalisation and asset relief scheme | Open to all credit institutions and branches operating in the Lithuan. market | Market-oriented remuneration | 5-August-2010 | |
| Nether. | C.I. 20 Guar. 200 | Guarantees for unsecured loans. | Any institution defined as a bank and having its corporate domicile in NL; has substantial business in the Netherlands, and an acceptable solvency ratio | Guaranteed debt instruments are subject to a fee of 50 basis points if the tenure is no more than one year, and 50 basis points and the 5 year average if more than one year; remuneration restrictions | 31-Oct-08 | 17 August 2010 –Approval of recap. of AEGON 30 June 2010 –Guarantee scheme extended 8 Feb 2010 – Commission temporarily approves recapitalisation package of €6.9 billion in favour of ABN AMRO and Fortis Bank Nederland 28 Jan 2010 –Approval of recap. of SNS Reaal 17 December 2009 – Extension of guarantee scheme 18 Nov 2009 - Commission approves ING restructuring plan and illiquid asset back-up facility 7 July 2009 – Extension of guarantee scheme 8 Apr 2009 –Investigation into state aid to Fortis Bank Netherlands and ABN Amro 31 Mar 2009 – Commission temporarily authorizes illiquid asset back up facility for ING for six months. 11 Dec 2008 – Approval for €750 million recap. of |

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|-----------------|-----------------|--|---|---|------------|---|
| | | | | | | <p>SNS REAAL</p> <p>27 Nov 2008 – Approval of Aegon recapitalisation with €3 billion through a special type of securities</p> <p>13 Nov 2008 – Approval of a €10 billion special securities recap. scheme for ING</p> |
| Poland | C.I. Guar. | Guarantee short and medium term debt to encourage inter-bank lending and offer liquidity to financial institutions | Unclear | “Strict conditions” for recipients. Eligible institutions may apply for the support under the scheme until 31 December 2009, but support may be granted later, within the six month period as from the day of the adoption of this decision | 25-Sept-09 | <p>30 June 2010 – Extension of support scheme</p> <p>9 February 2010 – Extension of support scheme</p> <p>21 Dec 2009 - Commission approves Polish bank recapitalisation scheme</p> |
| Portugal | C.I. 4 Guar. 20 | State guarantees for financing agreements and the emission of non subordinated short and medium term debt. | All banks incorporated in Portugal | The beneficiary who has called on a guarantee has to reimburse the state in full, either by paying back the loan or by exchanging it for preferential shares. | 30-Oct-08 | <p>23 July 2010 – Bank support scheme extended</p> <p>23 July 2010 – Commission orders recovery of illegal state aid from Banco Privado Português</p> <p>20 May 2009 – Approval of Portuguese €4 billion recap scheme for banks</p> <p>13 Mar 2009 – Commission approves underwriting of a €450 million loan to Banco Privado Portugues by six Portuguese banks</p> |
| Slovakia | | capital injections and guarantees to eligible financial institutions | systemically relevant banks incorporated in Slovakia, | Limits on time and scope | 8-Dec-09 | |

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| | | | including subsidiaries of foreign financial institutions | | | |
| Slovenia | Guar. 12 | The state guarantee covers, against remuneration, the issuance of new short and medium term non-subordinated debt with a maturity between 90 days and five years. | Solvent credit institutions, insurance, reinsurance, and pension companies are allowed to enter the scheme. | Beneficiaries will be subject to behavioural commitments to avoid an abusive use of the state support | 12-Dec-2008 | 30 June 2010 – Extension of guarantee scheme 17 December 2009 – Extension of guarantee scheme 22 June 2009 – Extension of guarantee scheme 20 Mar 2009 - State aid liquidity scheme to eligible financial institutions approved 12 Dec 2008 – Approval of guarantee scheme for credit institutions for non-subordinated debt with a maturity between 90 days and 5 years |
| Spain | C.I. 50 Guar. 100 | €100 billion in state guarantees; €30 billion - €50 billion to buy 'healthy assets' from banks. | All Spanish financial institutions | Government can only purchase AAA rated bonds; AA bonds can be purchased if banks agree to repurchase those bonds at a fixed price on a fixed date | 04-Nov-08 | 23 July 2010 – Bank support scheme extended 29 June 2010 – Approval of restructuring aid for Caja Castilla La Mancha 28 June 2010 – Bank guarantee scheme extended 28 Jan 2010 - Commission approves Spanish recapitalisation scheme (Fondo de Reestructuración Ordenada Bancaria (FROB)) 23 Dec 2008 – Commission approves Guarantee scheme worth €100 billion (perhaps increased to €200 billion) that will include issuance of notes, bonds, and obligations 4 Nov 2008 – Approval of fund for acquisition of assets from financial institutions |

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|-----------------------|------------------------|---|--|---|-------------|--|
| Sweden | C.I. 4.68 Guar. 140 | Guarantee scheme covering new issuances of short and medium term non-subordinated debt; recap scheme; state loans | All solvent banks and mortgage institutions incorporated and operating in Sweden | A limit on aggregate growth in balance sheet volume related to the guarantee, marketing restrictions, a prohibition to base significant expansion on the guarantee and restrictions related to staff remuneration | 30-Oct-2008 | <p>12 May 2010 – Clearance of Carnegie restructuring</p> <p>11 Feb 2009 – Approval of Swedish scheme to recapitalise banks</p> <p>28 Apr 2009 – Prolongation of Scheme until 31 Oct 2009; uncollateralised debt instruments with a term of up to five years, whereas it previously covered only maturities of up to three years</p> <p>29 Jan 2009 – Commission approves modifications to Swedish support schemes for financial institutions. Cancellation of growth restrictions of participating banks; includes more mortgage institutions</p> <p>16 Dec 2008 – Emergency liquidity assistance worth €225 million for Carnegie Bank</p> |
| United Kingdom | C.I. 57 Guar. 286 | €57 billion recap; €55 billion asset purchase; €286 billion to guarantee loans | All UK financial institutions | Government will consider adjusting dividend policies and executive compensation | 13-Oct-08 | <p>25 Jan 2010 – Approval of aid for restructuring of Dunfermline Building Society</p> <p>25 Jan 2010 – Approval of liquidation of Bradford & Bingley</p> <p>17 Dec 2009 – Extension of recapitalisation and guarantee scheme</p> <p>14 Dec 2009 – Commission approves impaired asset relief measure and restructuring plan of Royal Bank of Scotland</p> <p>18 Nov 2009 – Commission approves restructuring plan of Lloyds Banking Group</p> <p>28 Oct 2009 – Approval of restructuring package for Northern Rock. The bank will be split into a 'good' bank that will continue the economic activities of Northern Rock and a 'bad' bank, an asset management company that will liquidate the remaining assets</p> |

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| | | | | | <p>13 Oct 2009 – Extension of guarantee scheme</p> <p>7 May 2009 – Commission extends in-depth investigation into UK aid package for Northern Rock</p> <p>21 Apr 2009 – Approval of Asset backed Securities Guarantee scheme (special purpose vehicles collateralized with residential mortgages) of up to £50 billion (€57 billion).</p> <p>15 Apr 2009 – Extension of Credit Guarantee and recap schemes to 13 Oct 2009</p> <p>24 Mar 2009 – Working Capital Guarantee Scheme to offer banks €10 billion in guarantees for business loans</p> <p>23 Dec 2008 – Amendments to support scheme: guarantee debt instruments in foreign currencies; fee payable on guaranteed liabilities based on 50 basis points plus 100% of median 5yr CDS; can now roll over scheme for two more years</p> <p>13 Oct 2008 – Lloyds Banking Group receives a state recapitalisation of £17 billion (some €19 billion). The approval of this recapitalisation was conditional upon the submission of a restructuring plan.</p> <p>1 Oct 2008 – Commission approves UK rescue aid package for Bradford & Bingley</p> <p>2 Apr 2008 – Commission launches in-depth investigation into UK restructuring aid package for Northern Rock</p> <p>5 Dec 2007 – Commission approves UK rescue aid package for Northern Rock</p> |
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Source: DG Comp, EU Commission.